The Washington Monthly

DECEMBER 1982/$2

ON THE BRINK:

Labor And Management: Mutual Hari-Kari

The Service Economy: No Panacea

1929 And 1982: The Similarities and some glimmers of hope

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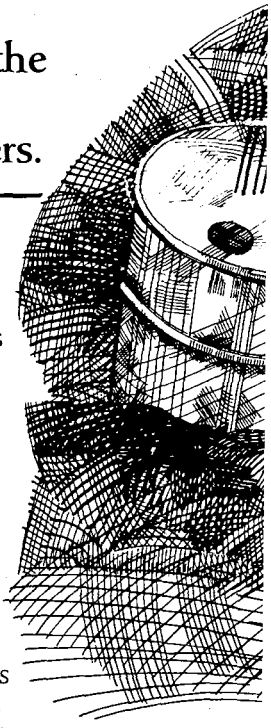
We're doing what has to be done.

Danger—Handle With Care!

Love Canal dramatized the dangers of hazardous wastes. Business, government, and the insurance industry are showing that today's dumps need not be tomorrow's disasters.



In a modern, heavily-industrialized society, waste materials are abundant and, in some cases, dangerous. Toxic leftovers from many industrial processes can pollute the environment, contaminate the water, and threaten the public safety. And, let's face it, serious accidents have occurred.

Today, the combined efforts of legislators, regulators, responsible waste-generating companies, the insurance business, and a concerned public are being felt.

New laws and standards go a long way toward making sure that firms that produce, move, store, or dispose of dangerous substances do so with care. Government tests and inspections are meant to assure compliance and minimize risk. Concerned industries have developed new technology and methods for safe waste disposal. But with materials this potentially dangerous, the best of care may not prevent every accident.

Although any accident with hazardous substances is bad news, some accidents are worse than others. And more insidious. Sudden spills and fires are quickly found and remedies quickly applied. Liability insurance for those accidents has been available for some time. But the material we're talking

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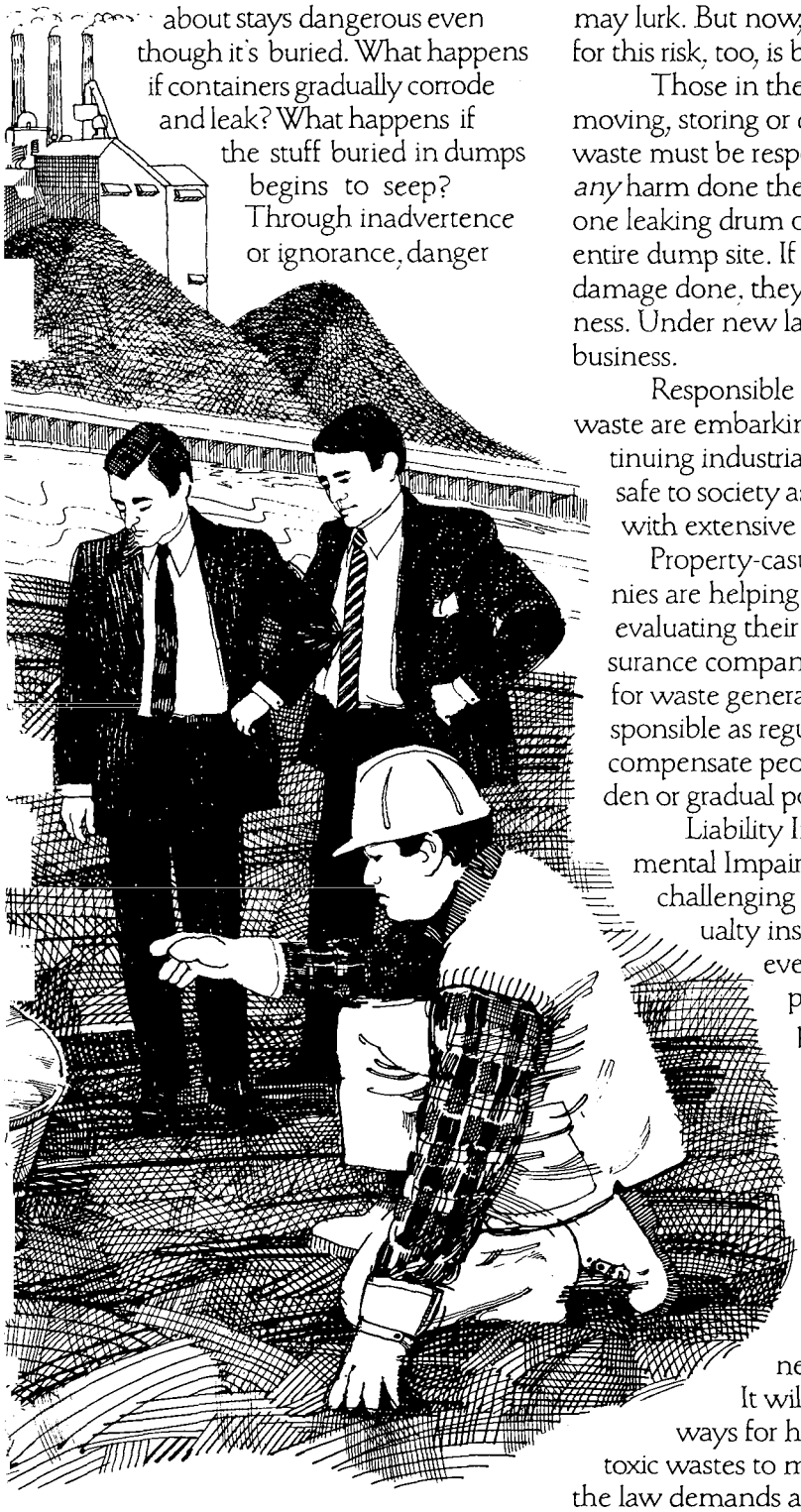

about stays dangerous even though it's buried. What happens if containers gradually corrode and leak? What happens if the stuff buried in dumps begins to seep? Through inadvertence or ignorance, danger may lurk. But now, liability insurance for this risk, too, is becoming available.

Those in the business of producing, moving, storing or disposing of dangerous waste must be responsible to the public for *any* harm done them—sudden or gradual—one leaking drum or the slow leaking of an entire dump site. If they can't pay for the damage done, they shouldn't be in the business. Under new law, they *can't* be in the business.

Responsible handlers of hazardous waste are embarking on a difficult path—continuing industrial activity in a manner as safe to society as possible and in compliance with extensive governmental regulation.

Property-casualty insurance companies are helping those waste generators by evaluating their risk potential. And now, insurance companies have devised a way for waste generators to be financially responsible as regulations require, able to compensate people harmed by either sudden or gradual pollution.

Liability Insurance for Environmental Impairment is one of the most challenging coverages property-casualty insurance companies have ever been asked to provide. The potential for loss to both people and property is large and little known. But if proper safety standards are issued and enforced by either federal or state government, and if insurance companies are allowed to administer the coverage with some sense of certainty, this new insurance can do a job. It will be one of the best ways for handlers and disposers of toxic wastes to meet the responsibility that the law demands and the public deserves.

We're working to keep insurance affordable.

This message presented by the **American Insurance Association,** 85 John Street, New York, NY 10038

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LETTERS

Better Read Than Red

With Nicholas Lemann's "Putting the Mind Over What Matters," (October) *The Washington Monthly* takes a giant step toward competing with *The New York Review of Books* as "America's most important and influential intellectual magazine." Mr. Lemann is obviously a man with ideas and the ability and intention of communicating.

MAURICE BEESLEY
San Francisco, California

I know you read *The Progressive* from time to time. In fact, your "Tilting at Windmills" column (October) contains a generous plug for Mary Williams's article about the impact of Reaganomics on the President's hometown, Dixon, Illinois. I find it all the more perplexing, then, that the same issue should contain a wholly inaccurate, not to say malicious, reference to our magazine.

I am referring to Nicholas Lemann's article, and particularly to his assertion that *The Progressive* and *The Nation* are "the only real continuing legatees of the soft-on-Russia side of American liberalism." *The Nation* can speak for itself. It's possible that Lemann knows nothing about *The Progressive*—but you do, and I assume you exercise some editorial discretion over the contents of *The Washington Monthly*.

You may not be aware of the fact that *The Progressive* has *always* taken a clear-eyed, unsentimental view of the Soviet state—from the early days of the Bolshevik Revolution through the purge trials and other abuses of the Stalin era. Surely you *do* know our position on Hungary in 1956, Czechoslovakia in 1968, Poland and Afghanistan today. We have condemned Soviet imperialism and adventurism abroad, as well as Soviet repression at home. Always.

If the reference to *The Progressive* in Lemann's article is not based on sheer ignorance (as it may well be in your author's case, but not in yours), it must be based on the doctrine that anyone who rejects the Manichean formulations of the Right and the simple-minded mumbo-jumbo of the Cold War must be on "the soft-on-Russia side." I would expect to encounter that attitude in the pages of *National Review* or *Commentary*. I'm disappointed to see it in the *The Washington Monthly*.

ERWIN KNOLL
Madison, Wisconsin

Erwin Knoll is editor of The Progressive.

While we are always pleased to be linked with *The Progressive*, we found Nicholas Lemann's characterization of our two journals as "the only real continuing legatees of the soft-on-Russia side of American liberalism" to be unworthy of your usually tough-minded magazine. I can only attribute this misinformation to lapsed subscriptions. Lest your readers be misled, I advise that they see for themselves. *The Progressive* is available from 408 West Gorham Street, Madison, Wisc. 53791 at $17 a year and *The Nation* at the introductory rate of $12 for half a year from 72 Fifth Avenue, New York, N.Y. 10011.

I will pass along Mr. Lemann's observations to our monthly columnist on Soviet Affairs, Professor Steven Cohen of Princeton University, who I know will be interested since his books have been banned in the Soviet Union.

VICTOR NAVASKY
New York, New York

Victor Navasky is editor of The Nation.

Nicholas Lemann replies:

Mr. Knoll, I apologize. What I should have said was that in the panoply of liberal magazines, *The Progressive* is particularly unrepentant about conventional liberalism. But under the Knoll administration and that of Morris H. Rubin for many years before that, *The Progressive* hasn't been soft on Russia. I know how infuriating it is for someone to make an offhand statement that ignores 30 years of work, and I'm sorry for having done that.

Mr. Navasky, not so fast. Let's let bygones be bygones and forget the notoriously Stalin-apologist *Nation* editorship of Freda Kirchwey, turning our attention instead to the present. I think a fair test of whether *The Nation* is soft on Russia is how it reacted to the two most recent situations in which the Soviet Union was completely and inarguably the bad guy: the intervention in Afghanistan and the proclamation of martial law in Poland. Cover stories on these subjects have not been reassuring.

As I read your major article on Afghanistan ("Wrong Moves on Afghanistan," January 26, 1980), its author, Fred Halliday, actually *applauds* the Soviet intervention. "Their desire was to stabilize a situation that had spiralled out of control," he says, trustingly adding that, in general, "Russia does not have a detailed 'grand strategy,' and insofar as it has a single overarching policy, it is what it has been since 1920: namely to support revolutionary governments where it can." The real villain in the Afghanistan situation, to Mr. Halliday's mind, is, of course, the United States, which engaged in "some of the most undiluted irresponsibility and crass demagoguery. . . for many a long year."

On Poland, your major coverage ("Jaruzelski Sends in the Tanks," December 26, 1981) was by Daniel Singer, author of the *The Road to Gdansk* (Monthly Review Press), and he was at least clearly outraged by the event. But he mentioned the Soviet Union only once, and only in passing. Several months earlier, in a long discussion of Soviet politics ("Socialism and the

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Soviet Bloc," February 14, 1981), Mr. Singer took the position that while Russia has had its problems over the years, it would be a mistake to eliminate it from the ranks of potentially progressive societies; he said he feels "a reluctance to accept that the changes embodied in the October Revolution ultimately led to a dead end." And need I add that Mr. Singer feels that even the worst excesses of Stalinism were really in large part the fault of the United States? "Sixty years ago the Western proletariat and its political parties failed to come to the rescue of the victorious and isolated Bolsheviks," he writes, and this "tragic failure" laid much of the groundwork for Stalin.

I read *The Nation* every week and often admire it. But it prints enough articles that give the Soviet Union every conceivable benefit of the doubt, and then some, to qualify it fully as the legatee of the "soft-on-Russia side of American liberalism."

Bowled Over

In your attack on snobbery at all levels you admonished *The Washington Post* for devoting such a small space in the sports section to bowling despite the fact that "4.8 million men and 4.1 million women bowl at least once a week" ("Tilting at Windmills," September). You seem to side with Mr. J. M. Arena of *Newsweek* that it may be because "bowling is a blue-collar sport."

What absorbing copy can be written about the repetitious, one-man act of rolling a black ball down a wooden path to knock over some wooden bottles. To the participant it's entertaining, to the reader of a sports section, it's dull and of no interest. Blue-collar workers flock to football, basketball, baseball, and hockey by the millions. Sports writers know their readers and cover every fumble, strikeout, and lay-up.

NORMAN L. KAUTSKY
Littleton, Colorado

Federal Bureau of Clarification

I would like to clarify two matters relating to Judge Webster which appeared in "Tilting at Windmills" in September.

The first matter concerns background investigations for presidential nominees. You indicated that Judge Webster has shown a reluctance to share information in this area with Congress. I can assure you that such is not the case. Historically, the White House deals directly with Congress in connection with presidential nominees. The FBI's role is to conduct investigations on nominees to assist the White House in its selection process. It has always been the responsibility of the White House to inform Congress of the investigative results. Judge Webster is in full agreement with you that Congress should be given all pertinent information upon which to make its findings. As you may know, the Department of Justice is in the process of reviewing the background investigative procedures for presidential nominees. The results of that review should be forthcoming in the near future.

In the other matter, you attributed to Judge Webster a quotation indicating that groups which "produce propaganda, misinformation, and legal assistance may be more dangerous than those who actually throw the bombs." This statement was actually made by a member of the Senate Subcommittee on Security and Terrorism. To specifically answer your question, yes, Judge Webster has indeed heard of the First Amendment and I believe his record clearly establishes his respect, appreciation, and protection of all constitutional rights.

ROGER S. YOUNG
Washington, D.C.

Roger Young is assistant director of the office of congressional and public affairs for the Federal Bureau of Investigation.

(See "Tilting at Windmills" for the editors reply.)

Volunteer for Jobless Corps

Alfred A. Fote's dictum: "Unemployment is a necessary, temporary concomitant when an economy must adjust to changing circumstances" ("Letters," September) prompts me to offer a modest proposal. A serious inconvenience that prevents some of us from accepting Mr. Fote's view of unemployment is that many of those who are "temporarily" thrown out of work while the economy adjusts cannot afford to be without an income.

I therefore propose that a corps of volunteers for the fight against inflation and technological obsolescence be formed. All members would be persons who either *can* afford to be without an income, or persons, like those occasional correspondents President Reagan professes to have heard from, who are so devoted to laissez-faire capitalism that they would be glad to starve in the service of their ideals.

When an emergency arose which required some temporary unemployment, volunteers (Mr. Fote would, I am confident, ask to be first among them) would take unpaid leaves of absence from their jobs for the duration or, if their skills were such as to make them irreplaceable, would contribute their entire salaries to a fund to provide unemployment compensation to persons whose lack of appropriate skills or lack of mobility preserved them from taking the jobs of the voluntarily unemployed.

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The adoption of my proposal, improving as it would both social justice and economic efficiency, would make all of us prouder to be Americans.

PHILIP MOE
Minneapolis, Minnesota

Feed the Artists

Re: "Artistic Licenses" by Philip Weiss, in the October issue. Nobody is sorrier than us artists that we have to eat and be sheltered from the elements. But romantic expectations have little to do with the rigors of life in New York City.

There is such a thing as Quality of Life, it is reflected in the city's tax base and its solvency, and artists do help to improve it. It's only fair that they share in the fruits of their labor. If Weiss doesn't like the way the city has found to accomplish this, he should suggest a better one.

PETER BASCH
New York, New York

Middle Level Snobs

"The Day They Stop Returning Your Calls" (Doug Bandow, September) was sad as well as ironic. It suggests that our middle-echelon employees in federal agencies gauge career fulfillment not by success in serving the public interest but by the number of meetings attended and memos received or generated.

James Fallows will excuse the incorporation of a minor update in English usage in a description of the Office of Policy Development (!) and its ilk: Bandow's people seem to operate in a dense pettifog impenetrable except to ego trips.

COLIN G. JAMESON
Key West, Florida

Premature Pulitzer

In your October issue, an ad placed by this agency for the E. P. Dutton book, *The Education of David Stockman and Other Americans*, by William Greider, contained an error that was embarrassing to all concerned—us, the publisher, but particularly the author, to whom we mistakenly awarded a Pulitzer Prize. The error had, in fact, been caught by the publisher, corrected by us, and then—due to the mysteries of computer typesetting and the failure of our people to perform the usual final check—reappeared in the ad as sent to you.

We would very much appreciate your readers knowing that neither publisher nor author were in any way responsible. My only hope is that we have not jinxed Mr. Greider by prematurely awarding him a prize that he should no doubt win on his own in the future.

LEE SIMMONS
New York, New York

Mr. Simmons is president of Franklin Spier, Inc. advertising agency.

The Washington Monthly

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Inflation at the *Monthly*

As a long-time subscriber to your magazine, I'd like to ask if you don't feel just a wee bit hypocritical poking fun at bureaucrats with inflated titles (Administrative Assistant to the Deputy Assistant Administrator, etc.) when you have the same problem yourselves?

I recently noticed something interesting: you don't have any writers. You've got an "Editor in Chief." And you've got "Editors." You've got "Contributing Editors." You even have an "Editorial Advisory Board." You must have one hell of a lot of writers to need all that editing, but there are none listed on your masthead! So who *writes The Washington Monthly*?

DOUG ELLICE

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TILTING AT WINDMILLS

It will not astound you to learn that the Reagan White House manages the news, but you may be just a bit surprised to discover that they admit it. Here's what Larry Speakes said in a recent dispute with the television networks: "You don't tell us how to stage the news and we don't tell you how to cover it." . . .

As further evidence that our concern about the proliferation of mindless snobbery in modern American life is not groundless, I call your attention to the "Flying Smart" commercial of Peoples Express Airlines. It begins with one young woman saying, "Before working for Peoples Express Airlines, I was a market research analyst." Then another says, "I have a masters in speech pathology," followed by, "I was a research chemist," "I have my masters in finance," and, finally, "I have a masters in art history and a Ph.D. in archeology," and "I was a translator for the French diplomatic corps." I kept hoping someone would say, "I know how to fly a plane.". . .

Speaking of the airlines, the FAA seems well on its way to undoing the good it did at the time of the air traffic controller's strike. You will recall the FAA then dealt with problems of a radically reduced work force by eliminating the traffic peaks that required the old high staffing levels. The result was safer travel—you were no longer terrified by the sight of several other planes zooming around yours as it circled endlessly in its 5:30 p.m. holding pattern—and a system that was cheaper to operate because it was no longer paying for controllers who really were needed only during the peak hours.

But now the FAA is bragging that it will restore the old system. Here's how the thinking of the administrator, J. Lynn Helms, was described by *The New York Times*:

"Mr. Helms said the rebuilding of the traffic system was, if anything, slightly ahead of the schedule laid down shortly after the walkout. He dismissed the contention that, while traffic volume might return to 100 percent, the goal would be met by spreading out flights to inconvenient hours. He said the planned abandonment of flight quotas in most areas meant that operators would again be able to schedule flights at times of their own choosing." . . .

If you get sick in Kansas City try to walk to the hospital. If you don't think you can make it, hail a cab. Don't call an ambulance. The local ambulance service is called MAST and here are two letters to the *Kansas City Star* describing the service it provides:

"I was driven eight blocks in a MAST ambulance with no treatment and billed $277.50," and "I am a patient who was taken to a local hospital recently by MAST ambulance service and charged $328.10 for the trip. I weigh under 100 pounds."

It was June of 1947, and I was sitting in the upper deck of Ebbett's Field watching Ewell Blackwell of the Cincinnati Reds pitch against the Dodgers. He had pitched a no-hitter in his last start and now he was working on another, a feat that had been accomplished only one other

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time in the history of baseball. As each inning went by and he came closer and closer, there was a palpable sense of a crowd united, even the Brooklyn fans, in rooting for him not to make the mistake that would spoil it all.

I was not to experience that feeling again until a couple of months ago when I read *Growing Up*, the story of Russell Baker's life from its beginning in poverty in rural Virginia in 1925 through his marriage to his wife, Mimi, and his first job as a reporter for *The Baltimore Sun* in the late forties.

By the end of the fourth or fifth chapter, I knew Baker was working on a masterpiece and I was rooting for him not to do something that would spoil it all. Blackwell finally made his fatal mistake in the ninth inning. Baker never made his. I called the result "a lovely book" in our October "Booknotes." I have now decided it is a great book, one that I am certain will be read—and read widely—a hundred years from now.

Mary McGrory once said that Baker looks like Huck Finn and writes like Mark Twain. The description delighted me but the Twain part didn't seem quite right. Baker had the humor, the same instinct for the right word, but, I thought, he lacked the humanity. He often struck me, as do so many witty people, as a very guarded person who used his wit for self-protection.

There was a reason for his wariness. His father died with shocking unexpectedness when Russell was five years old:

"That afternoon, though I couldn't have phrased it this way then, I decided that God was a lot less interested in people than anybody in Morrisonville was willing to admit. That day I decided God was not entirely to be trusted. . . . At the age of five I had become a skeptic and began to sense that any happiness that came my way might be the prelude to some grim cosmic joke."

Understanding what happened to him that day was, I suspect, the key that unlocked the door to Baker's humanity—to the completely candid self-revelation that, together with his usual wit and the customary total absence of even one wrong word, characterizes every chapter of *Growing Up*.

The central thread of his story is Baker's relationship with his strong-willed mother, Lucy Elizabeth, who drove him to achieve the success that had been denied her. He tells about her efforts to get him to "make something" of himself.

"The flaw in my character which she had already spotted was lack of 'gumption.' My idea of a perfect afternoon was lying in front of the radio reading my favorite Big Little Book, *Dick Tracy Meets Stooge Viller*. My mother despised inactivity. Seeing me having a good time in repose, she was powerless to hide her disgust. 'You've got no more gumption than a bump on a log.' "

Lucy Elizabeth never ceased trying to endow Russell with "gumption" until he finally freed himself by marrying Mimi, a union that definitely was not maternally blessed. But unlike so many other men who have been scarred by such obsessive mothering, Baker is able to look back on his mother without the slightest sign of resentment. He has found inner harmony or something very close to it. In that sense he reminds me of Shakespeare during the period in which he wrote *As You Like It* and *Twelfth Night*, capable of seeing even the harshest reality, but always doing so with love and without ever becoming heavy. I no longer have any reservations about the comparison made by Mary McGrory. . . .

The Japanese may continue to maintain trade barriers against our products and they may continue to refuse to pay their fair share of our mutual defense costs. But we *still* may be able to win our economic competition with them—or at least pull even—if the Japanese National Railway Corporation represents the wave of the future. It has become so featherbedded that it now spends $11.15 for every 38 cents of earned revenues, with a loss of $5.32 billion this year, which is expected to rise to $6.3 billion next year, and a total deficit of $29.2 billion. . . .

One of the problems with campaign finance reform is that the present members of Congress have too great a stake in resisting reform. Incumbents usually can attract much more money than challengers. Thus even such a high-minded liberal as Timothy Wirth recently refused his opponent's offer to limit their campaign spending to a figure under $300,000. "I spent $560,000 in 1980," said Wirth, who, as chairman of the House Subcommittee on Telecommunications receives contributions from such public-spirited organizations as MCI, RCA, and Data System Corp. "We'll spend more this time if we have to." . . .

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My favorite campaign reform remains the one suggested by Curtis Gans in these pages several years ago: outlaw manufactured TV spots. They are what the majority of campaign funds are spent on. Eliminate them and we will radically reduce the need for money in politics.

But, you say, how can we do such a thing without infringing on free speech? The answer is simple. We wouldn't dream of infringing on the candidates' right to put themselves on live TV and talk as long as they want to about any subject they want to discuss. They simply would not have the assistance of clever producers, film cutters, tape-splicers, and audio engineers who can depict any candidate as an unblemished hero and his opponent as an unredeemable rascal. The beauty of this idea becomes even more apparent when one considers how few candidates, upon mature contemplation of the risks involved, would dare subject the voters to extensive exposure to their unvarnished selves. The few who did would quietly learn from their polls that they were losing votes with every broadcast. . . .

In 1977 we noted, with some wonder about the licensing practices of American medicine, that Dr. Robert J. Sherman was being allowed to practice in Virginia even though his license had been revoked in the District of Columbia because of his negligence in performing an abortion that led to the death of a 16-year-old girl. Subsequently, the good doctor had to interrupt his practice to serve time in a federal penal facility, after pleading guilty to an indictment that said he had a "malicious interest in making more money, cutting his costs, and saving his time in disregard for the life and health of his patients."

Where is this kindly old physician now? According to a story on page A18 of the October 6 edition of *The New York Times*, he is practicing medicine in Massachusetts. A hearing was to be held on revoking his license. It was scheduled 28 months after a complaint about Dr. Sherman's record was filed with the Massachusetts Licensing Board. During that time Dr. Sherman's license was automatically renewed. The *Times* put the matter gently when it said that the story "rekindled public doubts about the ability of government agencies and medical organizations to identify and discipline errant members." . . .

You may think that the Dr. Shermans are isolated exceptions to the prevailing pattern of integrity in respectable medical circles, but consider the fact that last year the Stanford University Medical Center was caught double-billing. According to a report in the *San Francisco Chronicle*, "Stanford University has agreed to return $1.5 million in Medicare fees after a federal audit concluded that the medical center had billed the government for more work than was done, and, in some cases, billed different agencies for the same work. . . . The $1.5-million payback is on top of a reimbursement of more than $300,000 . . . for similar billing irregularities discovered in a state audit for the same period." . . .

If you can't trust your doctors, who can you trust? Well, certainly not your bankers. That seems to be the import of a recent story in the *Seattle Post-Intelligencer* headlined "A Family Lost Its Fortune When Bank Sold Its Trust."

A retired Seattle fireman who had bought a gas station in 1946 for $60,000 "put it in trust" with Pacific National Bank, now called First Interstate, for the benefit of his children and grandchildren. By 1973, the property was assessed for $426,000. Nevertheless the bank sold the property, without the fireman's knowledge, for just $200,000. This year the property, with a three-story building on it, was sold for $7.5 million. The bank continues to charge more than $2,000 a year to administer the trust. Still, a Seattle judge ruled against the fireman when he sued the bank.

When the *Post-Intelligencer*'s Timothy Egan asked Judge Norman Quinn why the $200,000 price was fair when just a few years later the property sold for $7.5 million, the judge replied, "That's a good question." Quinn went on to say "that the sale was 'legally proper' but 'probably poor public relations.' " The bank made no public announcement that it was selling the property. Could this have had something to do with the fact that the rest of the block was owned by one of the bank's main competitors, whose chairman said his bank "would have prepared an offer that would have reflected our desire for ownership of the entire block."

The lesson to learn from this is that bank trust departments are run for the benefit of the banks, primarily, and only secondarily for the trusts' beneficiaries.

As the fireman's wife said,

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"If you can't trust a trust, who can you trust?" Well, certainly not lawyers. New York's legislature in 1981 established a fund for people victimized by dishonest lawyers. "So high are the claims in the first six months," reports *The New York Times*, "that officials are worried that the fund may go broke.". . .

I know that from time to time I sound cynical, but really I am not. I do know doctors who are both skilled and devoted to their patients' welfare, lawyers who are wise and selfless counselors, bankers who care about their customers, even bureaucrats who are dedicated to efficient public service—but their number is not as legion as I would like and I think I should share with you my concerns about the rest of them. . . .

The office of the inspector general of the Environmental Protection Agency, Mathew Novick, has sent a memo to the staff entitled "Talking Paper on How and When to Purge Divisional Case Files of Material Which Could Prove Embarrassing If Released on FOIA [Freedom of Information Act] or Congressional Request." What I fear is that the average liberal Democrat will chortle with glee at this embarrassment to the Reaganites and not realize that the memo reflects attitudes deeply embedded in the bureaucracy, regardless of the identity of the occupant of the White House. When I was in charge of the Peace Corps's internal evaluation unit, nothing delighted me more than concealing from the Congress the reports that reflected adversely on my agency. . . .

My guess is that the Democrats would have taken over the Senate had the unemployment rise disclosed by the Bureau of Labor Statistics the Friday after the election been published one week earlier. The stories it inspired on the television news, like NBC's segment on November 6 about the despair of 70-percent unemployment in Renovo, Pennsylvania, would have changed the minds of at least that handful of voters—less than 50,000—who saved the Republicans' hide in the close races that determined Senate control. . . .

Television seems to heighten the impact of the news in the few days before the election. I think Jimmy Carter would have lost but would not have been buried under the landslide of 1980 had not the anger and disappointment over dashed hopes for the release of the hostages dominated the news the weekend before the election. Poor Carter—the day before the election was the first anniversary of the seizure of the embassy in Tehran—and thus an occasion for long features on all the networks vividly recalling all the frustration, humiliation, and failure of the preceding year.

The first example of this kind of television impact came in 1968, when it was, in my opinion, responsible for the narrow defeat of Hubert Humphrey by Richard Nixon. Humphrey had been steadily rising in the polls throughout October and appeared to be overtaking Nixon by the last week of the campaign. But the Humphrey surge, which had been helped by what seemed then like imminent peace in Vietnam, collapsed when Nixon's friend, Madame Chennault, persuaded the South Vietnamese to torpedo peace talks a few days before the election. The effect was to leave the voters, particularly the liberals Humphrey needed to get to the polls, feeling the same kind of anger that 12 years later was inspired by the disappointment over the apparent failure of the hostage talks. . . .

It is, however lamentable, a fact that many of the positions taken by this magazine do not command widespread popular support. I am delighted, therefore, to report this result from a *New York Times* poll conducted in October:

Asked what they would do about prison overcrowding, 66 percent of the respondents said they favored giving criminals convicted of nonviolent crimes sentences, such as community service work, that don't involve imprisonment. . . .

Have you always felt sorry for academics because of the financial sacrifices demanded by their dedication to the pursuit of knowledge? If so, you should weep no more. According to *Dollars and Scholars*, a new book by the former director of the Office of Institutional Studies of the University of Southern California, university professors make as much as their counterparts in the business world—if consulting fees are included. This helps explain the radical decline in teaching hours at American universities—the teachers don't have time to teach because they are so busy consulting.

Sometimes the professors not only consult but, as a recent article by William Boly in *California* magazine shows,

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they make fortunes out of the results of research that is financed not by them but by their schools or by the taxpayers. Biologists, in particular, are displaying world-class skill in reaping the rewards of the current excitement over gene-splicing.

Still, medical faculties remain the long-time, year-in-year-out champions of the outside income field. To give you an idea of how they have come to think about their entitlements:

When a New York State official claimed that the professors at state medical schools were seeking outside income ceilings that would permit them to make as much as $700,000 a year, John M. Reilly, representing the faculty members, replied in outraged tones that they were seeking "only" a $222,000 ceiling. . . .

Regular readers know that my blood pressure is adversely affected by the postal subsidy for the nonprofit *National Geographic.* In fact its executives and staff are among the best paid and cared for in journalism. And its readers are, in the words of the *Geographic*'s own advertising to advertisers, "up-scale." How upscale? According to *Marketing and Media Decision* the *Geographic* ranks high in the zip code clusters of "Blue Blood Estates," "Pools and Patios," and "Furs and Station Wagons" that are sought by advertisers who want to reach the wealthy. So why do the rest of us subsidize either a wealthy organization or its wealthy subscribers? . . .

Another crazy subsidy is the one given the PXs of the armed forces. The original idea of the PX was that soldiers in remote locations without regular stores should have a place to shop, and, because they were underpaid, it should be cheap. Today most are stationed near ample shopping facilities and they are no longer underpaid. There is a PX in the Coonskin Armory near my home town of Charleston, West Virginia. It pays no rent and charges no taxes. It serves 2,000 military reservists. It sells AM-FM stereo radio and eight-track tape players, toasters, fishing rods, cameras, tennis rackets, waffle irons, and other military necessities at prices that, according to *The Charleston Gazette,* are 5- to 66-percent lower than those offered by local *discount* stores. This, needless to say, does not stimulate local business.

A similar scam involves military booze. Did you know that you pay for the transportation of American spirits, beer, and wine from the Norfolk, Virginia, exchange headquarters to U.S. defense establishments around the world? According to Robert Eringer, who looked into this matter for us, this subsidy means that, for example, a 1.75 liter of Bacardi rum that sells for $26.10 in London and $14.88 in New York can be purchased at an American PX in Britain for a mere $5.50. . . .

You've heard about our overcrowded courts and the explosion of litigation that's behind the problem. Here's a solution suggested by three consumer groups:

Abolish the tax deduction allowed business for the expense of litigation. This would encourage businesses to use cheaper and more socially desirable means of dispute resolution such as mediation. It would also eliminate an unfair advantage the corporation has over the consumer. It can deduct legal expenses. He can't. . . .

In our "Letters" section an FBI official complains that we attributed a quote to William Webster that should have been attributed to Jeremiah Denton. We relied on *The New York Times*, which apparently made the error in the process of editing a dispatch from UPI. But this does remind me to alert our readers to the sources I rely on. On matters of fact, I accept what is printed in the *Times*, *The Wall Street Journal*, *The Washington Post*, *The Los Angeles Times*, *The Charleston Gazette*, and a dozen or so other papers I have come to respect for accuracy.

In the case of most of these publications, I see their sins as being largely of omission, and I try to point out from time to time examples of the blinders they wear, of the stories or parts thereof they don't tell. But when they do get a fact wrong, I'm likely to get it wrong, too, and you should know that. . . .

Fritz Hollings led a Senate charge in September that came within four votes of defeating the MX. He's going to try again and my guess is that his chances are good. Two of the senators who bit the dust in November, Howard Cannon and Harrison Schmitt, were favorites of the MX lobby—to the tune of $21,500 and $17,000 respectively in contractor contributions. So with two pro-MX votes gone, sanity may prevail and the dense pack may be consigned to the

continued on page 60

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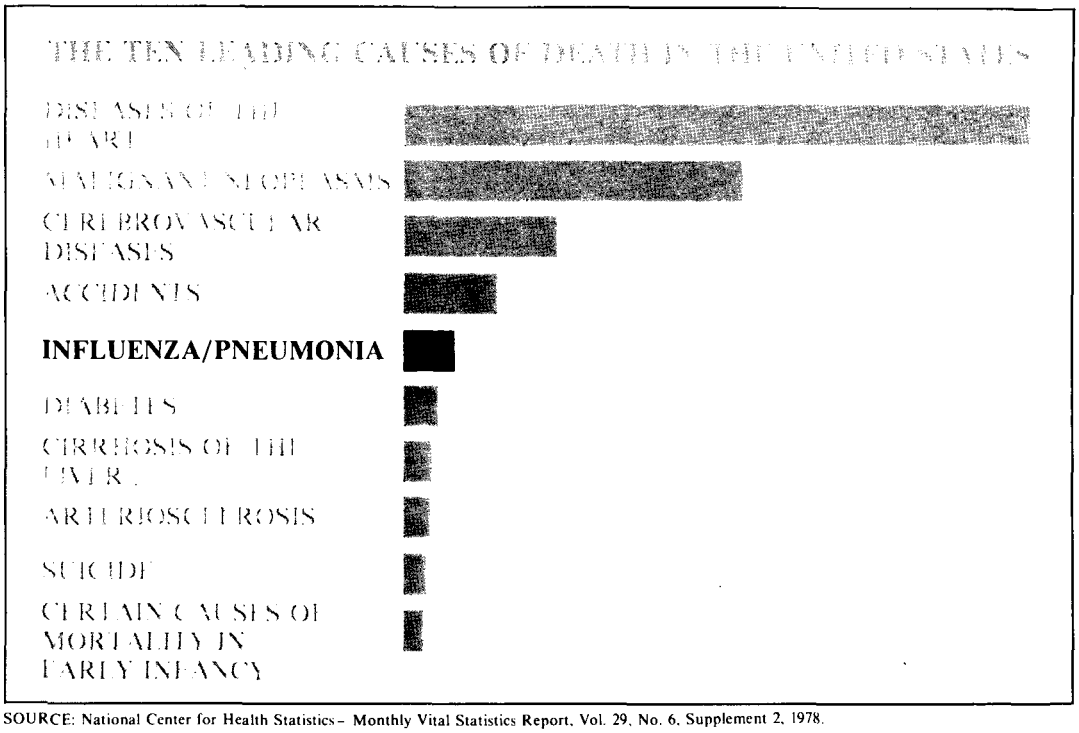
The disease that will not die... an untold story.



SOURCE: National Center for Health Statistics – Monthly Vital Statistics Report, Vol. 29, No. 6, Supplement 2, 1978.

Many of us believe that pneumonia is a disease of the past—long ago conquered by antibiotics. The fact is that bacteria-caused pneumonia strikes between 400,000 to 500,000 people, causing from 20,000 to 50,000 deaths each year, according to U.S. Government reports. A high percentage of these illnesses and deaths can be prevented—by a vaccine that has been developed, tested and proven effective.

A few million people are immunized; many millions more should be. Unfortunately, the very people most susceptible to pneumococcal pneumonia—the elderly, those with a history of chronic ailments, such as respiratory illnesses, heart disease, diabetes and others—may not know about the vaccine. They need to be informed.

Public attention, mainly through the media, has been mobilized to fight against disease—notably polio, other childhood diseases, hypertension, glaucoma, TB, and others. The time is now for pneumococcal pneumonia to be on that hit list.

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For information about pneumococcal pneumonia vaccine, call or write:
Public Affairs Department, Lederle Laboratories,
Wayne, New Jersey 07470, 201/831-4684.

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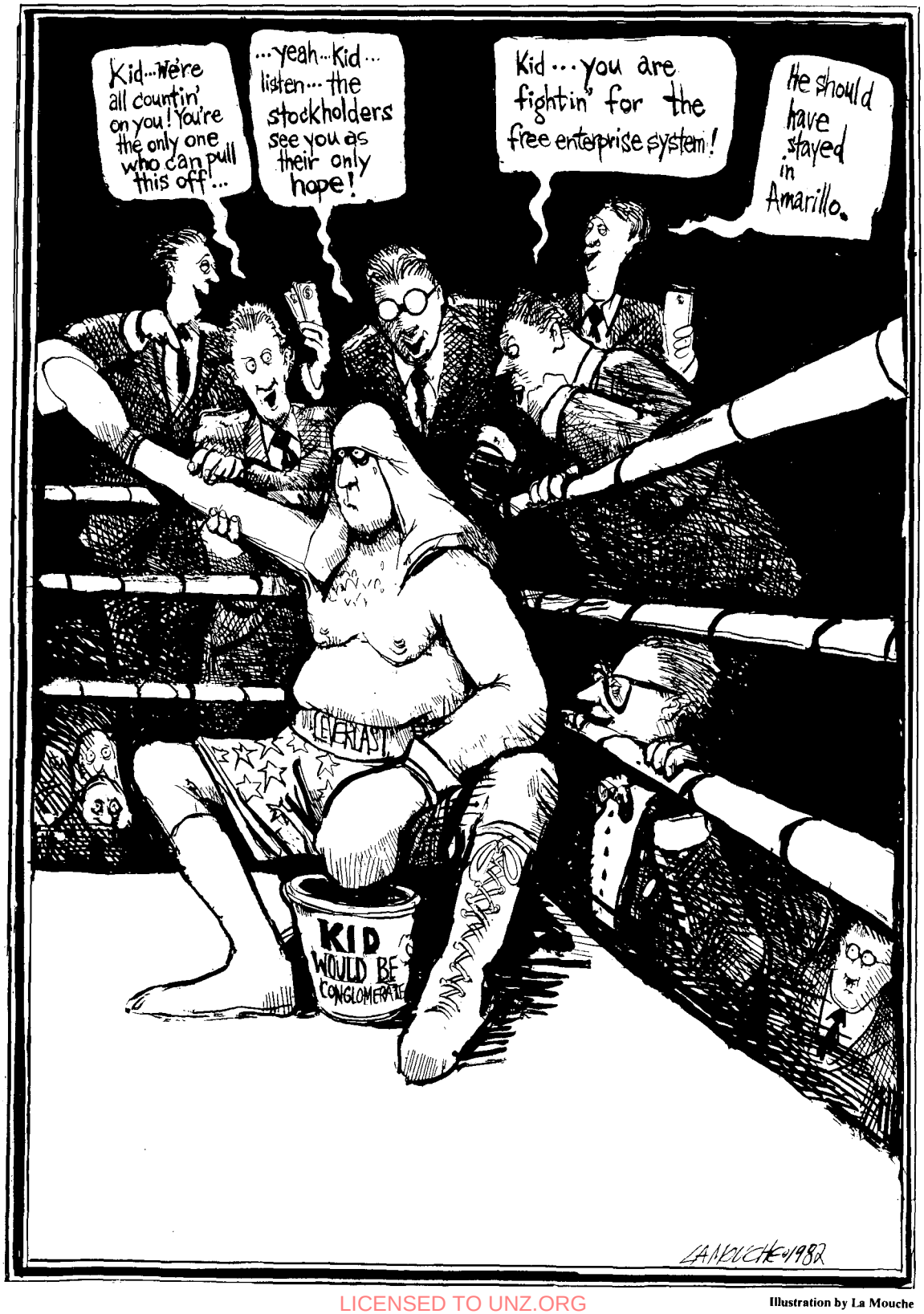

Illustration by La Mouche

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THE MERGER MONGERS

By Joseph Nocera

For some inexplicable reason, summer seems to be merger season on Wall Street, and this summer was no exception. The American General Corp., a Texas insurance giant, was tendering for the smaller (but still huge) NLT Corp. of Nashville, which in retaliation was tendering for American General. Pabst was trying to merge with Olympia. Diamond Shamrock of Dallas was negotiating a takeover of the Sigmor Corp. of Nashville. Then it was Pabst again, this time on the defensive as it tried to fend off a takeover attempt by one of its own unhappy stockholders. And of course, right at the end of the summer, there was the now-infamous Bendix-Martin Marietta battle, covered to death by the business press, immortalized in Doonesbury, and starring the man the business community loves to hate, William Agee, and his faithful sidekick, Mary Cunningham.

I was on Wall Street this summer to cover yet another of the season's big takeover attempts. Mesa Petroleum Co., a hot independent oil company out of Amarillo, was trying to take over the much larger Cities Service Co. of Tulsa. It turned out to be precisely the kind of big, splashy, eyeball-to-eyeball confrontation Wall Street loves. Each company had made an unfriendly tender offer for the other, and no one had any idea how it would turn out; it was exciting just to watch the plot unfold a little more each day. As one of Mesa's advisers was fond of saying, the whole thing was "a gigantic game of chicken."

Joseph Nocera is a contributing editor of The Washington Monthly. *This article grew out of a larger writing project on mergers for the* Texas Monthly.

Mesa, with $2 billion in assets, was one-third the size of Cities, and hence the underdog, but its chairman and founder, T. Boone Pickens Jr., was a man of both savvy and flair. Because Mesa had been one of the great growth stocks of the 1970s, Boone Pickens had made a lot of people on Wall Street a lot of money; for that reason, he was well-known and well-liked there. So people were rooting for him, though in their hearts most of them didn't think he could pull it off. But what those on Wall Street really noticed was that Cities had Bruce Wasserstein on its side, and Pickens had Joe Flom.

If you consider yourself reasonably well informed on financial matters and the names Bruce Wasserstein and Joe Flom don't ring a bell, you're not alone; even the most religious reader of *The Wall Street Journal* will come across their names only occasionally. Yet what I discovered during my time on Wall Street was that any attempt to understand the dynamics of a corporate merger—and indeed, of merger mania in general—is futile without knowing who these men are and what they do.

Joe Flom is the lead partner of the law firm of Skadden, Arps, Slate, Meagher and Flom, a legendary Wall Street lawyer, who almost single-handedly made "takeover law" respectable. Bruce Wasserstein is the co-director of First Boston Corp.'s mergers and acquisitions department and is supposedly one of the most hard-nosed investment bankers in the world of M&A.

These are the merger pros. When a corporate takeover attempt is in full swing, it is the chairmen of the companies doing battle—the William Agees of Bendix, the Harry Grays of United

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Technologies—whom you read about on the business page. But behind the scenes it is the merger pros devising the strategies, gumming up the works with lawsuits, or buying up stock in an effort to make the deal swing one way or the other.

But it's more than that, really. A corporate executive who wants to take over another company will come to Wall Street, make his play, and then return from whence he came. The merger pros stay to play another day. A corporate executive might spend his time trying to complete a merger—and then again, he might not. A merger pro, on the other hand, is entirely dependent on the game for his (usually lucrative) livelihood. He has a huge incentive to see deals completed, whether friendly or unfriendly, whether they make sense for the companies involved or whether they don't. So in general, merger pros are very much the activists, prodding, wheedling, playing to their clients' big egos, egging them on to fight to the end, to complete deals even when, as was the case with the recent Bendix-Martin Marietta war, calling the whole thing off makes the most sense. In this respect, they're a lot like the conniving Senate aide—subtly pushing the senator in the direction of his own agenda, but making sure the boss gets all the ink. You'll almost never hear of a merger pro advising his client to drop his dreams of merger glory and go back to manufacturing widgets. That takes money out of his pocket.

The nature of mergers, and the reasons for them, have changed dramatically in the past decade or so, and the merger pros have had a lot to do with that change. Takeovers are much bigger than they used to be, and a lot nastier. Whereas the key to doing a deal once was one man's ability to persuade another man that a merger was in the best interests of both their companies, today most big deals have at their core the notion that what counts most is moxie and money and the ability to play the tunes that make Wall Street dance. Whether the company being tendered for wants to be bought or not has become largely irrelevant. And it is the merger pros—particularly ambitious trailblazers like Flom and Wasserstein—who have invented the strategies and broken the ground and created the climate that has made unfriendly takeovers possible. Unfriendly takeovers, once considered the most unseemly of deals, now are completely respectable.

The Arbitrageur

In the insular culture of Wall Street, Guy Wyser-Pratte is considered something of a hot-dog; you walk into his office and the first thing you notice are the half-dozen framed articles about himself on his wall. But even if he were not that way, even if he were the shyest and most self-effacing of men, people on "the Street" would know about Guy Wyser-Pratte.

Guy Wyser-Pratte is a merger pro of a different sort. He plays a role there; he has a function. He is what is known as an arbitrageur, which is to say he makes his living not by working for one side or the other but by betting on the outcomes of corporate merger fights.

It was in the middle of this takeover battle that I first encountered Wyser-Pratte. He came by the Waldorf-Astoria one evening to pay a call on Boone Pickens. Wyser-Pratte, though an American citizen, is French-born and bred, and he looks the part. He is a tall, almost angular man who favors elegantly tailored suits and white shirts that require cufflinks. When he is listening to someone, he has a habit of touching the tips of his fingers together in a genteel, almost prissy, mannerism.

On this evening, however, Wyser-Pratte was doing a lot more talking than listening. He had come by to offer Pickens encouragement and, after a fashion, support. As a risk arbitrageur, Wyser-Pratte is not employed by either side, but rather works for himself and his firm. An "arb" (as they are called in the local dialect) buys up stock in the company he expects to lose in a tender battle and then tenders it to the expected winner. If he has guessed right, he can make millions of dollars in profits when the tendered stock is bought by the winner. And of course if he has guessed wrong, he can lose millions as well.

"Mr. Pickens," said Wyser-Pratte, "you *have* to win this thing. You're the only one who is fighting for the stockholders here. That's the battle I've been fighting all my life. It's about time managements start putting the interests of the stockholders above their own interests."

Pickens nodded and took a sip from his drink. But he had spent enough time on Wall Street to know to take Wyser-Pratte's comments with a large dose of salt. Yes, it was true, there was a case to be made that the Cities Service stockholders would be best served by having Boone Pickens take over their company. Pickens was known throughout the industry as a gifted, innovative oilman; Cities was known as a sluggish, back-

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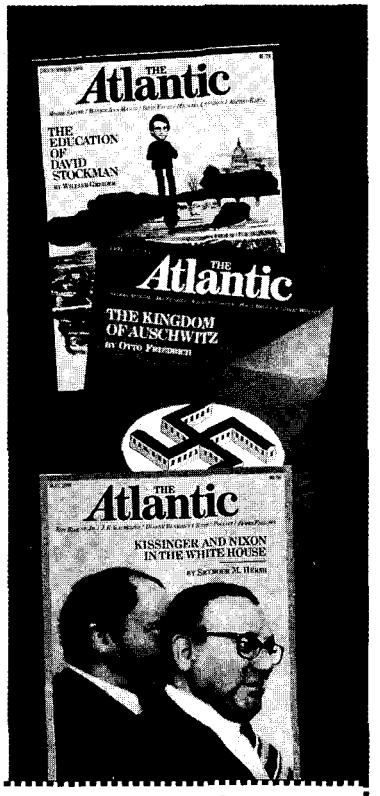

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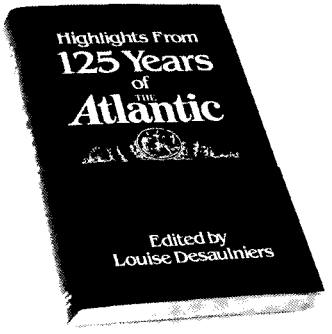

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ward-thinking company. Over the long haul, Cities would probably be a lot better off with Boone Pickens running it than with its current crop of managers.

But when Guy Wyser-Pratte talked about "the interests of the stockholders," he was talking in the first person. In any deal an arb gets involved in, he becomes in effect a very large stockholder of a company he wants to see sold off. He is not a stockholder for very long—only from the time he buys a stock to the time it is bought by the acquiring company. That can be anywhere from a few days to a few months (though for an arbitrageur, a few months is an eternity). What he wants is quick turnover, which means quick profits. Arbs are the quintessential short-termers on Wall Street. The last thing in the world they care about is what would be best for the company over the long haul. And Guy Wyser-Pratte, who was busily buying up Cities Service stock, was doing so because if Mesa Petroleum won this battle, it would be buying that same stock from him at a substantial premium over market. Wyser-Pratte, in other words, would make a killing. So while his crusade for the stockholders is undoubtedly genuine, motivated by what he sees as wrongheaded policies of many company boards, it is equally true that when a stockholder makes a profit from a merger, so does Guy Wyser-Pratte.

The next afternoon, I went over to Wyser-Pratte's office at Bache, Halsey, Stuart, Shields, Inc., where he heads the "risk arbitrage" department. I wanted to talk a little more about "the interests of the stockholders." "Managements," he said, shaking his head sadly. They were so unenlightened, he said. They were so parochial. "What they're supposed to be doing is taking care of their stockholders. But what they do is take care of themselves first." Again, there was some truth in what Wyser-Pratte was saying; in many a merger battle, what the management of the targeted company cares about most is preserving its own position. But again, it seemed to me that Wyser-Pratte was the last person to be making that argument.

He pointed to one of the articles on his wall. It was about a lawsuit Wyser-Pratte had filed aimed at forcing Gerber Products Co. to accept a takeover bid by Anderson, Clayton & Co. Gerber had fought the takeover, arguing (of course) that it was not in the best interests of the company's stockholders. When the merger attempt failed, Wyser-Pratte was furious. He had loaded up on Gerber's stock and was about to lose a bundle; and as a stockholder he felt rather strongly that *that* wasn't in the best interests of the company's stockholders. He lost the suit (stockholder suits almost never get anywhere in court), sold the stock, and that was the end of his interest in the fortunes of Gerber. By then, he was knee-deep in other mergers anyway.

Arbitrageurs like to see themselves as the keepers of the entrepreneurial flame in America. They take risks, you see; they can lose as easily as they can win. That they produce nothing of lasting value doesn't seem to bother them in the least. Talk to Wyser-Pratte about the *worth* of his work, and he gives you his spiel about helping the stockholders of America get a fair shake. Maybe he is making them a little money, but how, in the end, does that help the American economy? When I asked Wyser-Pratte that question, he gave me a perplexed look. What did I mean? he asked. I repeated the question. "*This* is capitalism," he answered finally. "If you take away my right to make a profit then you don't have a capitalistic system anymore. You might as well turn the country over to Leonid Brezhnev." The sad part is, I think he was being perfectly sincere.

The Investment Banker

In a *New Yorker* essay written over a decade ago, John Brooks described the old-line investment banking firm of Brown Brothers Harriman & Co. this way:

"Until a few years earlier, almost all Brown Brothers partners were Yale graduates; by 1968, merely a working majority were. Whether Yale men or not, the 1968 partners bore names familiar in American history, long past and present. In addition to a vintage Brown—Moreau Delano Brown, a great-grandson of the founder's brother—and [Robert] Lovett, a former Assistant Secretary of War . . . they included Prescott Bush, a former United States senator from Connecticut; Elbridge T. Gerry, a descendant and namesake of the onetime governor of Massachusetts . . . R. L. Ireland III, a grandnephew of Mark Hanna . . . and of course the elder Harriman brother, W. Averell, the lifelong diplomat and former governor of New York."

Brown Brothers Harriman was not unique in its preference for hiring the bluest of bluebloods;

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every investment banking firm on Wall Street did the same. Investment banking used to be that kind of profession—a place where a man of standing could go to work every day and still feel, well, civilized. Investment bankers never got down there in the muck with the businessmen they advised. Theirs wasn't that kind of profession. And they never, ever got involved in something that might leave a bad taste in the mouth—like an unfriendly tender offer.

That has changed now. One by one, the investment banking houses began putting together deals they once considered ungentlemanly; those that tried to hold out eventually broke down when they saw fees and clients going out the door. (Today only one investment house—Goldman, Sachs—still refuses to get involved in unfriendly tenders.) And eventually the ethic changed, too; investment bankers who held their noses when they did these deals were replaced by a new breed who loved doing unfriendly deals. Unfriendly deals required different values: winning was what counted. Huge fees brought higher status than proper bloodlines. Toughness meant more than politesse.

Today those values are in abundance in the investment houses that have a strong merger practice, but no house on Wall Street puts them at such a premium as the First Boston Corp. And no one investment banker embodies the new ethic to the degree that First Boston's Bruce Wasserstein does. At 35, he is a pudgy, curly-haired, thoroughly disheveled man, the very antithesis of the Yankee blueblood. He is also an apostate. In 1972, Wasserstein co-authored a book for Ralph Nader, *The Closed Enterprise System,* that attacked lax antitrust-law enforcement. Nowadays, Wasserstein is king of the multimillion-dollar merger pros. He and his partner, Joseph Perella, have made First Boston's mergers and acquisitions division the most lucrative part of the firm. Almost every big deal of late has involved First Boston, which is to say Wasserstein. The firm played a role in the $7 billion U.S. Steel-Marathon Oil deal (the largest in history), the du Pont-Conoco merger (the second largest), and dozens of others.

In the recent Bendix-Martin Marietta affair, First Boston at first was cut out of the action. This did not sit well with the boys at First Boston: "We wanted to get in the play—on either side," a First Boston source told *Fortune* magazine. And indeed they did. As Bendix chairman William Agee got deeper and deeper into trouble, he finally called in First Boston to act as co-adviser with Salomon Brothers. Soon First Boston was cutting Salomon Brothers out of the play, until it had almost completely taken over. None of these machinations prevented Agee's company from going down the tubes in the end (Bendix was bought by the Allied Corp.), but at least First Boston could claim its share of the fees paid out by Bendix.

Even more than most of his Wall Street colleagues, Wasserstein sees takeovers as full-fledged corporate wars; his great gift is supposed to be his talent for devising creative battle strategies. In the Mesa-Cities fight, for instance, he persuaded Cities to tender for Mesa as a purely defensive tactic—never mind that Cities didn't want Mesa and wouldn't have known what to do with it. It made sense as a battle tactic, not as a business proposition.

After the Mesa-Cities play was over—it ended in mid-June when Gulf Oil stepped in and offered to pay a far higher price for Cities stock than Mesa could afford—I went over to First Boston to talk to Wasserstein about the deal. He would not speak for attribution; that's not his style. But I don't think I'm breaking any great confidence to say that he, and other people I talked to at First Boston, harbored a deep contempt for Boone Pickens. Pickens, in the eyes of the merger pros at First Boston, was a mere businessman; all he'd done all his life was find oil. As important and challenging as finding oil might be, to these guys, it didn't compare with the challenge of big-league deals on Wall Street.

To hear Wasserstein tell it, not only would Pickens have finally lost if the deal had been played out to the bitter end (one of those things, by the way, that no one will ever know), but he was in over his head the minute he came to Wall Street. In the humble opinion of the merger pros at First Boston, Pickens had been outclassed, outmaneuvered, outplayed in every conceivable way. "He should have stayed in Amarillo where he belonged," said one Cities Service investment banker (not Wasserstein). "He must have been crazy to try to do this deal," said another (again, not Wasserstein). "There are only about a dozen people who really understand how these deals work."

In that last statement, of course, lies the mystique of the merger pro. He's the *expert,* or so his clients believe. He has the computers at his fingertips, and all the right strategies in his head. His power is very similar to the power a lawyer has over a client, or a doctor over a patient. The patient may privately question the advice of his doctor, but he doesn't often act on those suspicions. After all, isn't the doctor the one who's been through years of medical training, learning

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things the patient can never know? Similarly, CEOs feel compelled to take the advice of their merger pros whether they agree with it or not, since they're paying a small fortune to get that advice. And yet with the merger pro's fee usually tied to the outcome of the deal, there is always a fear that his advice will be skewed in the direction that will make the most money for the investment house.

The Wall Street cognoscenti can be quite cynical on this subject, as well they should be. There have been so many bad marriages on Wall Street in the past few years (starting with U.S. Steel-Marathon, which has been a disaster for both companies) that you have to start wondering: Why were they done at all? Why weren't the merger pros trying to stop some of those deals? The only answer that makes sense is that the investment houses themselves have so much money riding on the outcome that they are loathe to prevent them.

The Cities deal offers an intriguing case in point. When Mesa and Cities first went to war in the beginning of June, Cities had the following arrangement with its advisers at First Boston and Lehman Brothers Kuhn, Loeb (another large investment banking house with a strong merger department): each of the firms would receive a flat fee of $500,000 regardless of the outcome. In addition, if the battle ended with Cities buying enough shares to take over Mesa, the two investment houses would receive a "bonus" of $1.5 million each. About a week later, that agreement was amended to provide a bonus of $3.5 million each if Cities ended up with 90 percent or more of Mesa's stock.

But the merger pros weren't through yet. One Friday late in the deal, at a time when it must have become clear to the Cities board that Mesa had a good chance of winning, Cities decided it was time to look for a "White Knight"—that is, a company that would make a higher bid for Cities, and thus knock Mesa out of the play. Before the search began, however, Cities signed yet a third agreement with its merger advisers. This agreement spelled out a sliding scale of fees depending on how the deal turned out. If the White Knight acquired only 15 percent of Cities' stock, the investment bankers would get "only" $2.5 million; if the White Knight bought 40 percent, the advisers would get $4 million.

But the key provision in the agreement said that in the event of a deal that gave the White Knight majority control of Cities, the investment bankers would get $1 million for every $1 the stock sold above $50 a share. In effect, the higher the price Cities was killed off for, the higher the fees for the investment bankers. Cities' fate was sealed, one Wall Street analyst told me, the moment it signed that document. Three days later the Cities people were furiously negotiating with the Gulf Oil people, and two days after that Gulf offered $63 a share for Cities. That price meant a $13 million fee for First Boston. So whose idea was it to call in Gulf? That's right. Bruce Wasserstein.

The Lawyer

The investment banking houses aren't the only Wall Street institutions to have changed dramatically in the past decades. So have the Wall Street law firms, and largely in the same ways. They used to see themselves as cultured, gentlemanly places, well above the messy fray; today they plunge into merger work as eagerly as any investment banker. And the man most responsible for that change is Joseph Flom.

Flom first began doing "takeover law" in the late 1960s, at a time when everyone else on Wall Street thought it was beneath his dignity. He was good, and as mergers began to proliferate, it was Flom more and more companies turned to for help. He has become such a fearsome figure on Wall Street that some companies pay him a retainer simply to neutralize him, to make sure he will never be on the other side of a merger fight. Today Flom isn't just another partner at Skadden, Arps, he's *the* partner, and Skadden, Arps isn't just another Wall Street law firm, it's *the* firm to use for takeovers. And the takeover business has been very good to the firm: with 275 lawyers, it is the eleventh largest firm in the country, and one of the fastest growing, too. Flom himself makes more than a million dollars a year (even junior partners make about $300,000—well above what junior partners make at other New York firms). But there aren't too many jealous partners; after all, it's Flom's reputation that generates almost all the firm's business.

Flom's value to his clients comes in a number of different forms. First, because Skadden, Arps is so large, Flom can throw a small army into a takeover fight. His lawyers will work around the clock for weeks at a time, preparing the federally re-

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quired documents and proxy statements that are part and parcel of an unfriendly takeover bid, or running to Delaware (where most companies are incorporated) to file the plethora of frivolous lawsuits that are also standard in a merger fight.

Secondly, Flom himself, though he does none of the actual legal work, usually becomes a key part of a corporate executive's strategic team. When a merger fight is in full bloom, the people who are putting the deal together are often in the same room together for as many as 20 hours a day. Under these conditions, specific lines of responsibility become blurred; the investment banker will start giving legal opinions, the lawyer will make public relations suggestions, and so on. In this setting Flom is especially good. Because he has been involved in so many mergers, he can build on the strategies he has used in deals gone by. It also helps that he knows the people on the other side; chances are he has worked with them on other deals and can therefore help psych out the opposition. (This is particularly comforting to the executives, many of whom wouldn't know Bruce Wasserstein if they fell over him.) And he has a talent for coming up with creative nonlegal ideas that help push a merger the way he wants it to go.

The incentive of the arbs and the bankers is to push a deal—even a bad one—to fruition because that's the way they earn their fees.

For instance, Flom invented the "vanishing author" defense for Houghton-Mifflin. When in 1978 Western Pacific tried to take over the venerable publishing house, Flom's strategy was to have all of Houghton-Mifflin's best known—and best selling—authors threaten to go to another publisher if Western Pacific won. Faced with the possibility of buying a publisher that had no authors, Western Pacific backed off.

Flom charged Boone Pickens $1.1 million for three weeks' work. Pickens not only didn't complain about the size of the bill, he thought Flom was worth every penny. It was like the old joke about the refrigerator repairman, Pickens would say: He charges $1 to tap the side of a refrigerator, and $999 for knowing where to tap. Pickens, a very conservative man, also liked to remark that Flom was a liberal. But then he would add that that didn't matter to him. What mattered to Pickens was that Flom was working as hard as everyone else in this deal and for the same reason: to win.

But what struck me as I was watching Joe Flom was how he always seemed to have some sense of what his own institutional interests were. One such interest was simply his desire to see a good thing last as long as possible. All the heavyweight takeover lawyers have to be aware, at least subconsciously, that there is a constant undercurrent of anti-merger sentiment on Capitol Hill. For the moment, that sentiment is right where the merger pros want it—beneath the surface—but that is not to say it will always stay that way. A merger fight that is simply too big, or too brutal, or that turns out to be too obviously self-destructive for the companies involved, might be just the thing to tip the balance in the other direction. No merger lawyer is ever going to consciously pull his punches for that reason; on the other hand, no merger lawyer wants to be the one who's involved in the deal that causes Congress finally to pull the plug on unfriendly mergers. So here's Joe Flom, at the end of the Mesa deal, talking to Martin Lipton (another takeover lawyer almost as legendary as Flom): "If you people go ahead with this thing [continuing with the tender offer for Mesa] we're going to have to get very rough. And if that happens, we could get to the point where the Congress comes in and puts a limit on loans [for mergers]. This could be the one that screws it up for all of us." By making that argument, he was playing to Lipton's institutional interest.

Flom's other institutional interest has to do with his relationship with the other Wall Street merger pros. Although in this deal Wasserstein and Lipton were on the other side, it wouldn't always be that way. Boone Pickens would end up in Amarillo no matter how things turned out; Joe Flom would have other deals, and in some of these he would be on the same side as those people he was now fighting. (Last year when Mobil went after Marathon Oil, for instance, First Boston and Skadden, Arps joined forces to defend Marathon. In two other mergers, Skadden represented the company under attack and First Boston brought in the White Knight.) And so, since he had a lunch date with Wasserstein, Flom kept it. He and Lipton are old friends, and they remained that way throughout the course of this fight. Above all, none of them wants to do anything that will slow down the pace of the merger mania.

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What's one to make of the merger pros? As someone who spent some time close to the center of one corporate takeover battle, I know how interesting these men are, and how much they contribute to the adrenaline-fueled excitement that characterizes these confrontations. Though they're usually overlooked, men like Wyser-Pratte, Flom, and Wasserstein make good copy.

But when one stops to ponder what they really do, some different conclusions emerge.

First, although they've obviously got a great little thing going there on Wall Street, they are not doing the rest of us any good. They affect the economy of this country in dramatic ways, and quite often are doing it under the worst of circumstances. Yet the incentive of the merger pro is often to push a deal to fruition—even a bad one—because that's the way he usually earns his fee.

As for the arb, his role is even less justifiable than that of the corporate advisers. For it is he who is looking to make the short-term killing on the stock market, often at the expense of the long-term interests of the companies involved. In this arbs are merely the most visible (and possibly the most greedy) symbol of a far more widespread phenomenon. Everyone on Wall Street today—from the pension fund manager to the investment analyst—thinks exactly the same way. Short-term is all that matters. In fact, most of these people have no choice but to think short-term; their fiduciary duty to the people whose money they manage forbids them to do anything else.

Yet the original purpose of the stock market was not to make short-term profits for arbs but to provide the working capital businesses need to stay competitive. The stock market still does serve

Running Out Of Juice

This is the tale of a merger that went badly. There's nothing particularly unusual about what happened, but it's sometimes easy to forget that behind all the split-second Wall Street deals lie flesh-and-blood companies.

Check the batteries in your flashlight or in your kid's electronic game. Are they "Rayovac"? Probably not. The reason is a merger that turned a thriving company into the doormat of the industry.

In the summer of 1974, Wall Street was rocked by a hostile takeover war between blue chip giants. The combatants were Inco, Ltd., the Canadian nickel mining giant, and United Aircraft Co. (later known as United Technologies). The prize was ESB Inc., owner of the Rayovac battery company and manufacturer of other electrical products.

By today's Bendix-Martin Marietta standards, the contest for ESB was a sandlot softball game. But in the financial community, the struggle over ESB was a milestone, because when ESB brushed aside Inco's unsolicited bid in July 1974, Inco impolitely raised its offer. The first unfriendly bidding ever between two corporate giants for another firm had been joined.

ESB fought back, bringing United Aircraft in as a white knight. But to no avail. Inco bid the price of ESB from $19.50 all the way to $41 a share and United Aircraft dropped out. Rayovac would now be owned by a company with no experience in consumer products.

Up to this time Rayovac had experienced nothing but good fortune. Established in 1906 in Madison, Wisconsin, the firm soon became the nation's number one battery maker. By World War II, the brand was as familiar as Kleenex or Hershey, and the company employed thousands of people in several states. In 1957 Rayovac's owners decided to sell out to ESB (formerly Electric Storage Batteries, Inc.), a Philadelphia electrical products company. It was a very friendly merger. Rayovac remained number one in U.S. battery production, and ESB manufactured other products that dovetailed neatly into Rayovac's activities, including auto batteries, battery chargers, and electric motors. The parent company knew its subsidiary's business well.

But the unfriendly merger with Inco was something else. It not only angered ESB but, like most of the big mergers, raised eyebrows at the Justice Department. For four years, lawyers squabbled, and ESB's status as a subsidiary remained in doubt. Inco capital, which had been expected to flow into ESB, did not flow as deeply as envisioned—after all, the merger might finally be disallowed and Inco, like many other companies involved in disputed mergers, was thus reluctant to risk throwing in a lot of money. Until 1978, the year a consent decree was finally worked out, Inco's managers didn't have time to worry about much of anything except completing their complicated deal.

But if the new executives in charge of Rayovac had other things on their minds, the same wasn't true for the competition. During the 1970s, Rayovac's two leading competitors in the U.S. home battery business, Duracell and Eveready, made great strides. Eveready jumped into first place through clever

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that function to some extent—through mechanisms like debt offerings and equity offerings—but not nearly as much as it should. That's why I came to believe, as I watched the Mesa-Cities battle unfold, that the ethic of the merger pro is precisely what we don't need on Wall Street right now. The merger pro sees the corporate takeover as a challenging, exciting game in which the goal is to outwit the other side and win the fight by any means possible. He stresses corporate machismo and he sees corporations more as prey to be hunted than as living, breathing entities that employ people and make products and do all sorts of other non-stock market things. More than at any time since World War II, American business is in deep trouble, and the last thing its leaders should be doing is proving they have hair on their chests by conquering other companies. They should be using the stock market to get the capital that will allow them to retool their plants, or start new enterprises that will allow American business to compete effectively with, say, the Japanese. That won't have the sex appeal of a takeover fight, but it will be a lot more useful. In effect, American business needs to tell the merger pros that their services are no longer required, thank you.

But that's a hard thing to do, for mergers *are* fun and exciting. If you spend any time watching a merger up close, it becomes very easy to understand why that's where the smartest people coming out of business school gravitate. And it's equally understandable that American executives can be so under their spell. Yet, fundamentally, they are taking our eye off the ball. We need productive investment a lot more than we need to be entertained by corporate merger plays. We need our smartest people to be *in* business, not on its periphery.

If they ever write the history of the downfall of American capitalism, the Guy Wyser-Prattes and Joe Floms and Bruce Wassersteins and the rest of the merger pros deserve to be included. They'll rate a very long chapter. ■

advertising. Duracell rocketed into second place primarily on the strength of its new, long-lasting alkaline batteries. The Inco team, meanwhile, was slow to see the new market trends, especially in alkaline cells. By 1979, Rayovac had dimmed to number three and was slipping fast.

It wasn't that ESB-Rayovac technicians weren't up to speed. In fact, they had long since developed the technology to produce both alkaline cells and maintenance-free car batteries. But Inco could do nothing with it. "The battery maker's trouble was not lack of R&D but too many managers," *Business Week* reported in early 1979.

The labyrinthine management structure that resulted from the merger made it much more difficult to bring new products to market. Even Inco president Charles Baird conceded that "we couldn't run ESB like one of our own businesses." The combination of additional bureaucratic layers and unfamiliarity with the product was lethal in such a quickly changing industry. And once Rayovac's market share dwindled, Inco refused to pump in enough new money to catch up with the competition, in part because the merger fight had, as usual, caused the stock of the target company to be overvalued.

Meanwhile, Inco itself was taking a bath, largely because of the sad state of the metals and minerals industry worldwide. This fall it posted third quarter losses of $66.4 million, its largest losses since the Depression. As debts mounted in 1981, Inco decided it would have to divest itself of ESB. But in order to do that, Inco had to find a way to make the company look as attractive as possible to potential buyers, and what buyers often want in such cases is a company with stripped-down overhead.

So the layoffs have come quickly. From a 2,100-person payroll in Wisconsin, Rayovac is now down to below 1,600.

Just so you don't think Rayovac's problems are endemic to the battery industry, consider that this year both Duracell and Eveready are racking up profits for their parent companies, Dart & Kraft and Union Carbide, respectively. Duracell paced the way for Dart & Kraft's consumer and commercial products division, and Eveready sales are up ten percent over last year. Mergers have affected the corporate structures of these companies, but they were *friendly* takeovers, involving managers who knew something about their businesses.

Of course when you've been batted around enough, the difference between friendly and unfriendly begins to wear a bit thin. In September of this year, Inco found a buyer for most of the Rayovac division of ESB. What the sale will mean for employment in Wisconsin is unclear, but residents are understandably nervous. Some recall an article in the *Madison Capital Times* after Inco "won" the battle for Rayovac in 1974.

"Takeover Not Expected to Cut Rayovac Jobs," the headline read.

—*James Rowen*

James Rowen is a Wisconsin writer.

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Industrial America'

Anyone who has surveyed America's economic landscape recently knows one thing all too well: it's littered with bodies. As of mid-September, 17,502 businesses had failed in 1982; at that clip, casualties by year's end will exceed 25,000. That's four times the number that failed in 1979 and 5,000 more than the toll during the worst year of the Great Depression. What this number doesn't include is even more important: the thousands of mills, factories, and assembly lines that large corporations have closed during the recession—and which will never reopen even if flush times return for America's economy.

High interest rates, a deepening worldwide recession, and fierce international competition have given many of these failures a certain, albeit grim, logic. But anyone who's taken the trouble to perform autopsies will discover that a distressing number of these victims died of unnatural causes: namely, the greed, selfishness, and inflexibility of those who both owned and worked in them.

Consider just two cases. In March 1980 Champion International closed its 300-employee plywood mill in the small community of Willamina, Oregon. Champion, whose 1980 sales exceeded $4 billion, justified the closure by citing the declining fortunes of the lumber industry caused by high interest rates and a drop in housing starts. While the timber industry certainly is in a slump, several smaller, locally owned mills in the immediate area remain open to this day, having resorted to a variety of stratagems Champion never tried, such as shorter work weeks and reduced shifts.

What was most noteworthy about the Champion closure was a figure that inadvertently emerged when the company unsuccessfully tried to sell the mill: in its last full year, 1979, the mill showed a profit of $800,000. But that wasn't enough profit for the Michigan-based conglomerate, which was promising its shareholders an 11 percent rate of return. So rather than try to nurse the ailing mill back to health, Champion decided to pull the plug.

Quite a different reason lies behind the demise of Ford Motor Company's auto parts plant in Sheffield, Alabama. This June, Ford announced that it would close the facility, which had been losing money since 1974 and could no longer be carried in the face of Ford's $1 billion annual loss. But Ford gave Sheffield's workers plenty of advance notice and a choice: they could buy the plant themselves, with help from the company, or they could take a 50 percent cut in wages and benefits, which then averaged $21 an hour.

Officials of the United Auto Workers mulled over the choice—and decided to do neither. Rather than succumb to the demands of management, the UAW local decided the jobs were not worth saving. So during 1983 some 800 union members gradually will be laid off, and the small town of Sheffield will have lost one of its best paying—and biggest—employers.

The Champion and Ford examples illustrate a disturbing penchant among both business and union leaders for an economic version of mutually assured destruction. Healthy, often profitable businesses are being debilitated and even killed off by corporate managers bent on maximizing short-term return to please Wall Street investors. Their concern is not with profit but with *how much* profit; not with the long-term health of an enterprise but with its ability to contribute to a dazzling quarterly earnings report. Belden Daniels, a professor of urban planning at MIT who has studied more than a dozen plant closings in depth, observes: "Plants are closing that don't have to because we've trained our corporate managers to maximize their rate of return—not in ten years, not over one year, but over 90 days. Period. And it's killing us."

Unions unfortunately show similarly self-destructive tendencies. Rather than moderate wages and benefits that have priced their employers' products out of the market, unions too often are willing to sacrifice their members' jobs to preserve the "integrity" of contracts. The attitude

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Suicide Pact

by Phil Keisling

is best summed up by Peter Kelley, a member of the UAW and founder of a group called Locals Opposed to Concessions, who recently told *The Wall Street Journal*: "It is our firm belief that it wasn't our wages or benefits that caused the auto industry's problems in the first place. It was management—the bean counters—that made bad decisions and bad investments." Think about that. Even if Kelley is correct, assigning the blame won't do a thing to save jobs, and saving jobs is what we need to do.

Blue-Collar Bourgeoisie

No one suggests that hard-working Americans return to the days when wages for a 12-hour work day were barely sufficient to cover the costs of living in a rented shack and when union members were roughed up regularly by company goons. Fortunately, America's working men and women have come a long way since then—so far, in fact, they've left most of the rest of us behind.

Today, those who work in highly unionized industries such as automobile assembly, steel, rubber, and mining have attained a standard of living that is the envy of a vast majority of Americans. The average automobile or rubber worker earns

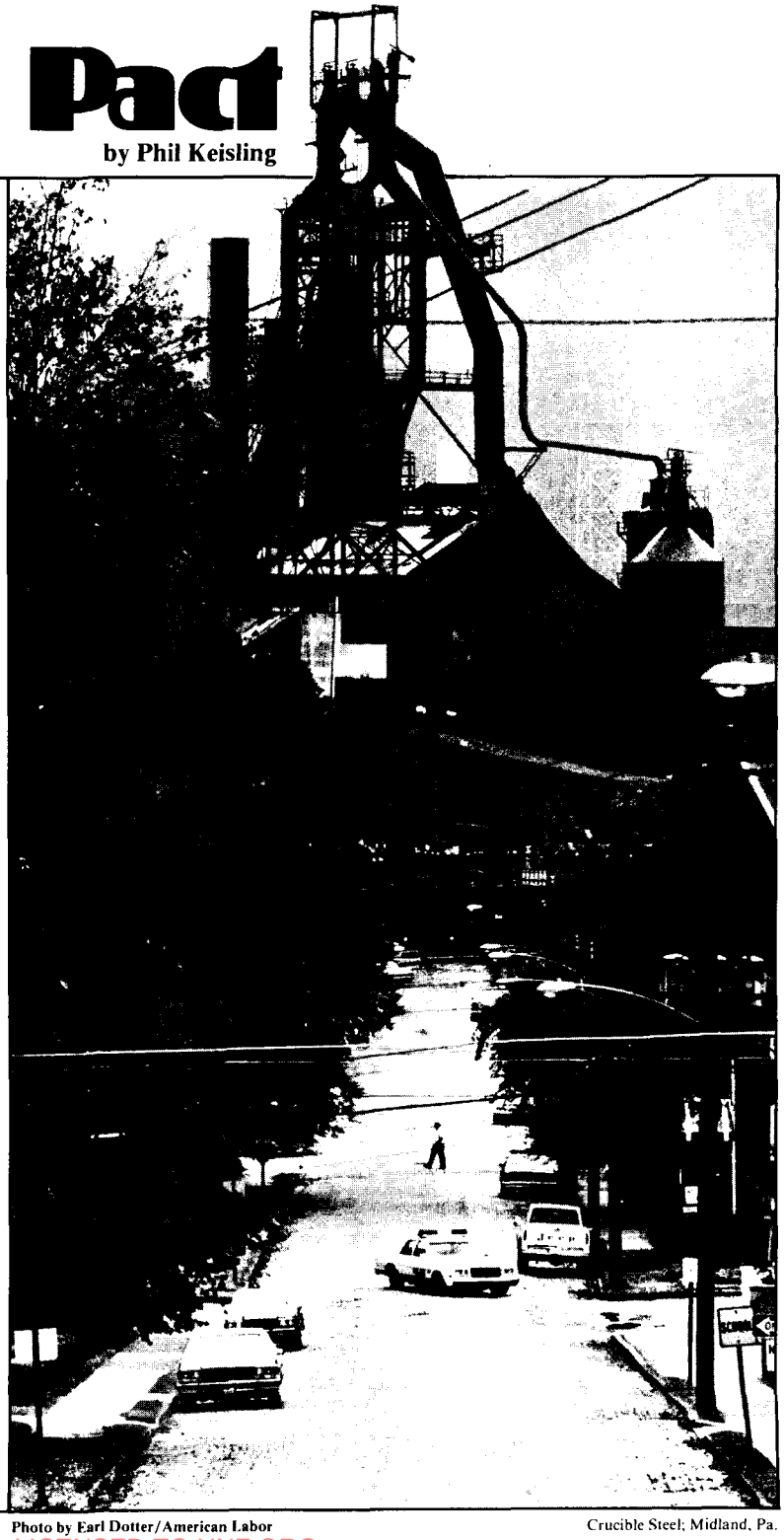

Photo by Earl Dotter/American Labor

Crucible Steel; Midland, Pa.

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substantially more than $20,000 a year; steelworkers now get at least $16 an hour, or more than $30,000 a year.

Consider the circumstances of a 45-year-old steelworker making $30,000 a year with a wife who makes $15,000 (not an unusual case, since today half of all married women work). That household is better off than 85 percent of those in the rest of America. Auto and steelworkers who have jobs are hardly Marx's starving proletariat.

Clinging resolutely to the myth of degradation is a prescription for self-destruction. Take a close look at the steel industry. During most of the last decade the industry has been governed by something called the Experimental Negotiating Agreement. In return for labor's pledge not to strike, management promised to tie compensation to a welter of cost-of-living adjustments and escalator clauses that bore no relationship to productivity gains or other measures of the industry's basic health. As a result, compensation has increased far faster than inflation: since 1962 the Consumer Price Index has doubled while steel industry wages have tripled.

And don't forget the fringe benefits. During this same period their value more than quadrupled. Among those benefits: fully paid health and dental care; pensions that will give a 30-year veteran about $600 a month on top of social security; and 13-week vacations every five years for "senior employees," which usually means about half the work force in a given mill. Then there are the paid holidays the union negotiated for everyone. Last October 25, when more than 100,000 steelworkers were drawing unemployment, those still on the job had the day off with full pay—to celebrate United Nations Day.

No wonder labor costs in the steel industry are nearly $25 an hour—double the average for all U.S. manufacturing jobs. And to a large extent, labor has consciously made a trade-off: higher wages at the expense of jobs. In 1965 the iron and steel industry directly employed more than 500,000 people. Last year the work force was 390,000, the lowest since records were started in 1933. The slow erosion of jobs over the past decade and a half now threatens to become a sudden, violent contraction. Many analysts estimate more than half of those laid off will never return to work. In a moment of candor, spokesman Gary Hubbard of the United Steelworkers is even more pessimistic. "Ten years from now there may be only three or four mills in America, rather than 300," he says.

The prediction may come true—partly because of the steelworkers themselves. For example, there was U.S. Steel's 1,200-employee fabricating plant in Gary, Indiana. After informing the union local that it could no longer compete with other companies that used cheaper, imported steel, the company asked for a deferral of a scheduled wage increase—not a wage cut, just a deferral. The local refused even to consider the proposal, and in 1979 the plant was closed for good.

This spring more than 7,000 steelworkers permanently lost their jobs when Wheelabrator-Frye Inc. closed its three railroad-car manufacturing plants. Wheelabrator-Frye acquired the plants in 1979 after a friendly takeover of Pullman-Standard. Though one certainly can question Wheelabrator's enthusiasm for keeping the business alive (the main object of its takeover bid was Pullman's engineering firm, whose acquisition has since put Wheelabrator into the same international class with Bechtel), there is little doubt the Pullman subsidiary was on the ropes.

So last fall the company asked the union for various contract changes in order to keep the plants open. Some concessions the union accepted, but changes in health benefits and seniority rights were angrily rejected. Wheelabrator wasn't bluffing; this spring it closed its Butler, Pennsylvania, and Hammond, Indiana, facilities for good, holding out hope it may reopen its Bessemer, Alabama, plant, but with no more than 400 employees.

Steel, auto, and railroad manufacturing are hardly alone. In the beleaguered meatpacking industry, there's the John Morrell Co., a subsidiary of United Brands Co. This spring it asked 800 employees at its Arkansas City, Kansas, meatpacking plant to take a 40 percent cut in wages and benefits that then averaged $19 an hour. The union rejected the demand as "outrageous" and stood by its insistence that all meatpackers, regardless of where they're located or their company's financial conditions, should receive identical compensation. In June Morrell closed the plant.

To be sure, there are some heartening cases where labor concessions have averted disaster, at least temporarily. In the automobile industry, the UAW's renegotiation of its contract with GM saved four plants, and in the case of the steel-

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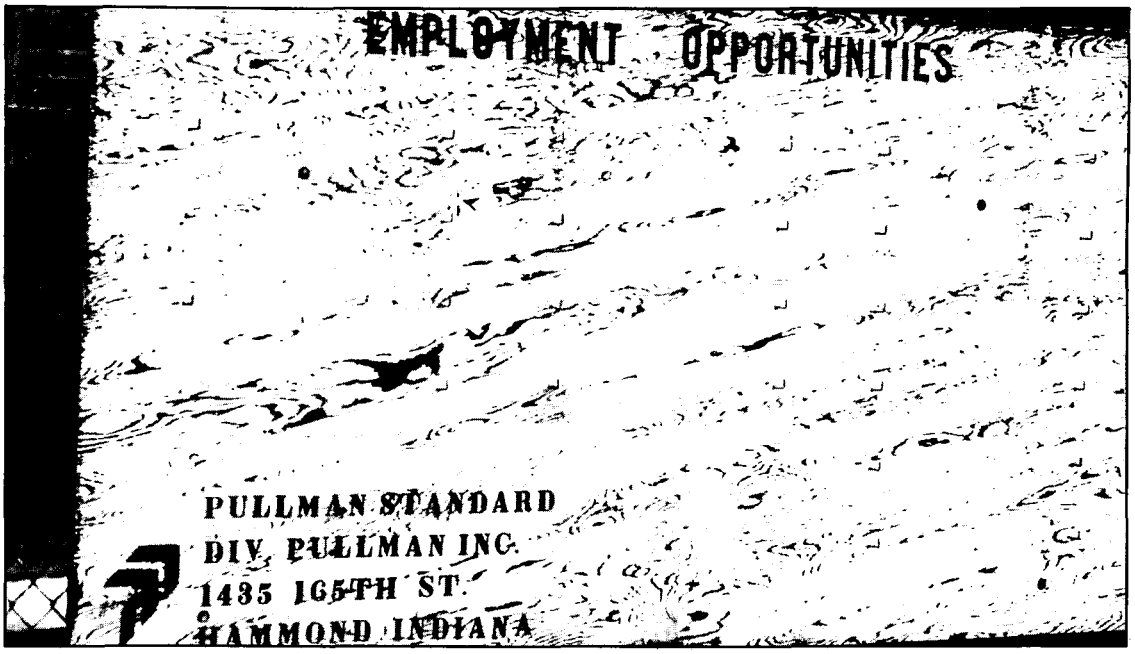

Photo courtesy of United Steelworkers of America

Pullman; Hammond, Indiana

workers, Wheeling-Pittsburgh's steel mill was kept open when the union agreed to accept stock in the company in lieu of a scheduled wage increase. Still, in neither case were actual wage *reductions* involved; in fact, such reductions still are quite rare.

The most common form of union concessions in these situations involves changes in work rules and job classifications. What's most interesting about these seemingly small changes is that they can make big differences in a plant's profitability—which is a sad commentary on how unions historically have demanded wage increases that bore no relation to productivity.

The case of Pullman-Standard's passenger-car plant in Hammond is instructive. For many years the union insisted that the plant's 1,800 employees be divided into no fewer than 150 job classifications. Carl Alessi, an official in the UAW local that represented workers at the plant, admits, "We'd have some guys who had to put in Phillips screws on the windows; another guy would have to put in the regular screws." Alessi estimates that reducing the number of job classifications to 25 would have improved productivity "100 percent." The union agreed to do so in eleventh-hour bargaining with Wheelabrator; but coming after past losses of several hundred million dollars, it was too little, too late.

The automobile industry has similar problems. At a former GM auto parts plant in Hyatt, New Jersey, the local UAW leader, Jim Zarello, admitted to one reporter, "It's no secret that the union helped create an atmosphere where people who were in the plant for eight hours did four hours of work." (Fortunately, there's a happy ending to this story: After purchasing the plant from GM, employees took a 25 percent pay cut and consolidated their job classifications. Productivity has improved 20 percent and the plant is still operating.)

Even in cases where labor and management agree on concessions, the difficulty suggests that relief may be only temporary. Last spring in Waco, Texas, United Rubber Workers Local 312 went out on a 119-day strike when General Tire proposed changes in their contract. In addition to small benefit reductions (rather than full hospitalization coverage, the company proposed that workers pay ten percent of their hospital bills, up to $400), the most controversial proposal was that 40 percent of the cost-of-living adjustments be disbursed according to the plant's performance. No reductions were asked in wage rates that average

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$12 an hour. Only when the company was on the verge of closing the plant did the union end its strike and accept the changes.

"If things are really bad, once you're asked to make concessions it's usually too late to save the plant," union local president John Dawson told *The Wall Street Journal.* Dawson now looks back on the strike with evident pride: "It was so dog-gone effective we almost put them out of the bias ply [tire] business."

Unemployment Insulation

There are several explanations for the unions' reluctance to make substantial concessions, even when the failure to do so results in the complete loss of members' jobs. The most obvious is the traditional animus between the two parties, fueled by long memories and previous examples of bad-faith bargaining. Unions deeply suspect that companies are using the recession to break them or exact concessions they could not get otherwise. Union leaders also are understandably outraged at the extravagant salaries that corporate executives receive, most of which bear no relationship to actual performance.

But there's another, more personal reason union members often are willing to see jobs destroyed rather than make the concessions necessary to save them. Plant closings are traumatic experiences that leave both workers and communities devastated. Yet paradoxical as it may sound, in many industries there is surprisingly little urgency to agreeing to cutbacks. In fact, in the calculus of what individual workers stand to gain, what they must give up, and the hardships they must endure if they lose their jobs, the case for concessions often isn't compelling enough.

To illustrate this, consider those who worked at Ford's Sheffield, Alabama, plant. The average worker there was 48 and had 15 years' seniority. Sixty percent already were eligible for some kind of retirement benefits. After being laid off, workers are eligible for state unemployment benefits, supplemented by payments from Ford, which together will insure they take home 90 percent of their previous salaries. When state unemployment benefits expire after 39 weeks, they will be eligible for special trade readjustment assistance from the federal government. This money is targeted for employees who lose their jobs supposedly because of foreign imports and is equal to state unemployment benefits. With 15 years' seniority, all these benefits can last as long as two years.

Once the benefits expire, if the workers are 55 or older, they can opt for early retirement and begin to draw pensions. If they are younger than 55, the recent UAW pact hammered out with Ford and GM makes them eligible for something known as the "guaranteed income stream." Until they retire or turn 62, typical Sheffield workers with 15 years' experience will be guaranteed about $12,800 a year.

Other unions have similar arrangements. Idled steelworkers get up to $180 a week in addition to regular unemployment. Older workers, under a new contract provision called the "rule of 65," can retire if they worked in a mill that was closed and their age plus years of service totals 65 or more. A 45-year-old worker who started at age 25 would be eligible for a pension of about $400 a month, payable even if he finds a job elsewhere.

None of these provisions, of course, makes a worker financially better off losing his job than keeping it. Rather, they contribute to a deceptive sense of security, as workers decide to wait out what they prefer to think is a temporary downturn rather than consider concessions.

Most important, these provisions highlight the fact that within unions, members have widely divergent interests. Younger workers, many of whom will get nothing from their contributions to the pension and supplemental unemployment funds, have an obvious interest in preserving their jobs. The alternative very likely might be a minimum-wage job; reports from some Ohio and Pennsylvania towns are that McDonald's has 30 applicants for every new opening. Though older workers suffer special problems in finding new employment, those who choose an early retirement can expect a good pension, a lot of free time, and the satisfaction of having "stood up" to the bosses.

Union officials, understandably, are loathe to admit any such conflict between older and younger workers. But many on the other side of the bargaining table notice this phenomenon. "One reason I don't think the workers wanted to buy the Sheffield plant or take a pay cut," speculates Ford spokesman Ed Snyder, "is that so many were close to retiring they didn't figure it was worth all the trouble." U.S. Steel vice president Andrew Staursky offers the same explanation for why the local in Gary, Indiana, also declined to make concessions to keep a plant there open.

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Corporate Punishment

If anything, the malfeasance of the other partner in this *danse macabre*—corporate executives—is even less excusable. The most egregious cases are like Champion's—the closure of profitable enterprises in a manner that jeopardized or destroyed existing jobs. In 1976, for example, Sperry Univac closed its library equipment manufacturing plant in Herkimer, New York, because its 12 percent rate of return compared unfavorably with a 22 percent profit "hurdle" the company had imposed on all its divisions. In 1979 U.S. Steel closed 14 mills, several of them marginally profitable; the resulting $850 million tax loss helped generate the cash flow that the company used to raise $7 billion to acquire Marathon Oil in 1982. Earlier this year the National Steel Corporation announced it would close its 8,000-employee mill at Weirton, West Virginia, because the mill's one-percent return on sales of more than $1 billion wasn't sufficient.

In other cases, companies jettison once-profitable plants at the first sign of trouble. In 1980, for example, Gulf Resources and Chemical Corporation, a $350 million Houston minerals firm, recorded $20 million in income from its Bunker Hill zinc, silver, and lead mining and smelting complex near Kellogg, Idaho. But in August 1981, after recording $7 million in losses for that year, Gulf decided to close the operation permanently rather than await the upturn in this highly cyclical business. "Additional investment required in the plant would severely limit the growth prospect of the other subsidiaries and the accomplishment of Gulf's overall goals," managers told shareholders. Gulf then took $83 million in losses that it wrote off against its other income.

More common are cases of corporate managers eviscerating profitable plants because they're not profitable enough—thereby assuring that they never will be. A classic case involves Youngstown Sheet and Tube's steel mill in Youngstown, Ohio. In 1969 the company was purchased by Lykes Brothers, a steamship company with visions of conglomerate grandeur. Lykes proceeded to siphon off Youngstown Sheet and Tube's large cash flow to repay the $150 million it borrowed to buy it and to finance other acquisitions. Investment in the mill plummeted just when modernization was critical in the steel industry; after missing out on the steel boom of 1970-74 because of antiquated equipment, Lykes was unable to weather the subsequent downturn in the industry and finally closed the plant in 1977, idling over 4,000 employees. After destroying a once-prosperous steel company, Lykes also squelched any chance that the mill could reopen when it sold out to Jones and Laughlin, another steel company. Former employees and Youngstown investors wanted to buy the mill, but the new owner refused to sell to what would have been a potential competitor.

The same thing happened two years later when U.S. Steel closed its 3,500-employee Youngstown mill. U.S. Steel president David Roderick stopped

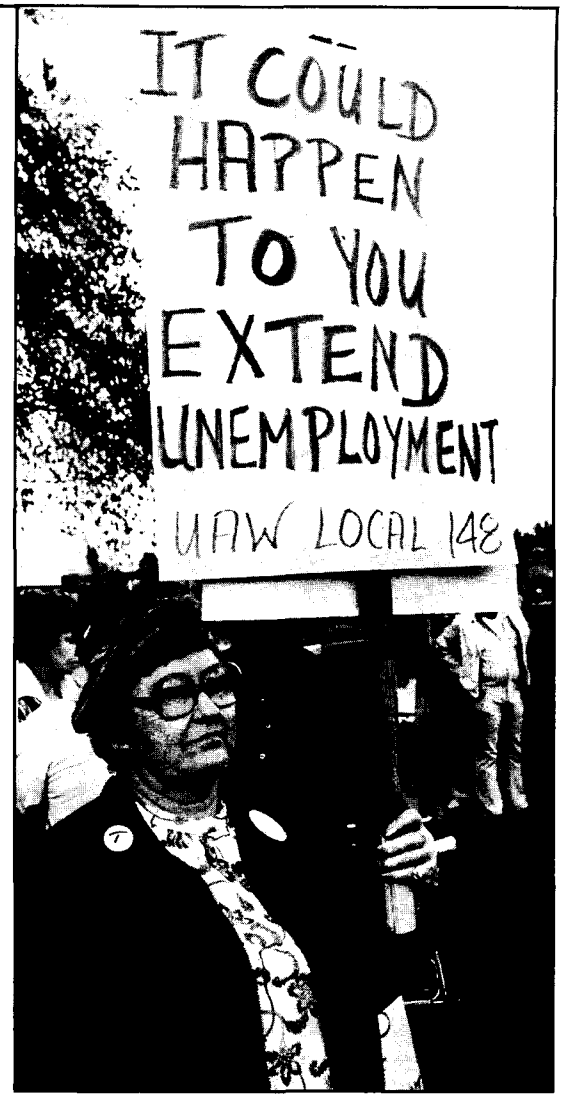

Photo by Cliff Kalick/UAW Solidarity Ford Motor Company; Pico Rivera

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a local effort to purchase the plant with a federal loan, declaring, "We are not interested in creating subsidized competition for ourselves at other locations." The same week Roderick made his ringing defense of the free market, he was in Washington lobbying for increased federal protection from foreign competition and more generous depreciation schedules for plant and equipment.

Unnecessary plant closures such as Youngstown Sheet and Tube illustrate a popular way of managing corporate assets. This "portfolio management" approach has even acquired its own special vocabulary—courtesy of one of the nation's most prestigious consulting firms, the Boston Consultancy Group. The firm's bread and butter has been in advising clients to divide their operations into a four-part matrix that looks at market shares and sales growth. Those divisions with low market shares and low sales growth, nicknamed "dogs," should be sold or closed, even if nominally profitable, because they will require constant reinvestment (like Bunker Hill). Operations with high market shares but low growth rates (like Youngstown Sheet and Tube) are "cash cows" that should be milked for large amounts of capital to divert into more profitable enterprises.

Robert Hayes of the Harvard Business School describes how this world view leads to the deaths of otherwise viable enterprises. "The same mentality of labeling a division a 'dog' applies to plants as well," he says. "And if you conceive of your role as a financial asset manager, when you're not personally involved in any of your operations, it's very, very easy to just say, 'let's pull our chips out of it.'" Michael M. Thomas, a former director of corporate finance of Lehman Brothers, who refused to handle the Lykes takeover because he foresaw correctly that it would result in the death of both firms, adds, "Everything now is done by the numbers. People sit down and have lunch at the 21 Club and make these decisions (about closing plants) and there's no human check, no thinking about the effect on the community. And what everyone forgets is that good business can't be done just by numbers."

This is not to suggest that plants should be maintained on artificial life-support systems if recovery is impossible. Some plants deserve to die; it made no sense, for example, to keep vacuum tube radio plants open once the transistor radio made their product obsolete. What's important is distinguishing those businesses that are doomed because of technical obsolescence or vanishing markets from those that can be profitable even

North Andover, Mass.

Photo by Earl Dotter/American Labor

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though they promise only a small rate of return over the long-term.

Malefactories of Wealth

Indeed, this is the most glaring deficiency of American capitalism: its hostility to the marginally profitable firm. Just as unions insist on preserving higher-than-competitive wages even at the expense of jobs, so corporations insist that otherwise profitable enterprises be closed. If a plant can be expected to generate a two-percent rate of return on investment over the long term, while lending the money out to the government would reap a ten-percent return, the shareholders' verdict is unequivocal: the plant deserves summary execution.

By the dictates of Wall Street, this makes perfect sense; to workers and their communities, the logic is particularly perverse. Shutting such plants causes a litany of familiar repercussions: larger deficits resulting from swollen welfare rolls, strapped state and local relief efforts, increased health and emotional problems. These corporate decisions reverberate widely because the money that workers and their families once spent in the stricken area's retail shops, car dealerships, and other businesses dries up—generating additional unemployment.

So what can be done? First it's important to look at the most frequently proposed device to keep marginal firms alive: plant closure legislation, the AFL-CIO-backed plan that would require major companies to give up to two years' notice before closures or large layoffs and to provide workers and their communities with large severance payments. "We have to slow the process of disinvestment," observes Bennett Harrison, an MIT professor who, along with Barry Bluestone, wrote *The De-Industrialization of America*. "Advance notice will give workers and their communities a chance to adjust, to restructure their jobs, and to do some economic planning," he adds. "Every other industrialized country we trade with has plant closure laws—why shouldn't we?"

The reason we shouldn't is that the ability to adjust quickly to changing circumstances and investment opportunities may be one of the few advantages America has right now over its foreign competitors. And while advance notice where possible is certainly desirable, requiring it won't prevent closures. Nor can it distinguish between those corporations whose decisions to close plants are motivated solely by greed, from the entrepreneur who makes heroic but unsuccessful efforts to keep a plant alive.

Plant closure legislation also doesn't address current problems; Harrison can convincingly document the sequence of corporate irresponsibility that results in plant closures—but ask him about what he would do if he worked at Sheffield and he doesn't have an answer.

The first way to help marginal firms is also the most obvious: wage and benefit concessions. Workers should be willing to take a temporary reduction in wages and benefits (insisting corporate executives do the same) while tying future raises to the company's performance. In return, corporations must open their corporate books; their argument that secrecy is necessary to protect their "competitive position" not only presumes workers want to help destroy their own jobs, but is silly since breaches of security are far more likely to come from corporate managers, who are as mobile these days as the capital they control. Finally, unions must begin negotiating on a company-by-company basis. Master contracts now in effect for the rubber, steel, and automobile industries help force marginal firms out of business by tying wages to the most profitable firms' ability to pay, thereby increasing the economic concentration unions themselves so often decry.

That last point is particularly ironic, because the evidence is overwhelmingly clear: the probability a marginal firm will close increases in direct proportion to the size of its parent. A conglomerate with headquarters in a distant city will be far more likely to shut such a plant than the local entrepreneur who lives in the community—and will probably continue to live there if he goes out of business.

Rather than let its marginal plants drop into the abyss, the nation should be creating a type of "social safety net" for them that will allow for their orderly transfer to the hands of those with a much greater stake in their survival: local investors and—even more so—their own workers (see "Give It to the Proles," page 47). Those that decry such local buyouts as "lemon socialism" are missing the point altogether: they actually represent the best aspect of entrepreneurship by letting those most affected by a business share in both the risks and the rewards of operating it.

The fate of Sperry Univac's former library

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The fate of Sperry Univac's former library equipment plant in Herkimer, New York, is instructive. After Sperry announced the closure, a group of former employees and local investors borrowed $2 million from a special federal program run by the Economic Development Administration. The last loan was crucial. "Without EDA, we couldn't have made it," says company president John Ladd, who says other local financing depended on the loan. The company is not only profitable, but now employs more people.

Such loans promote the best of both worlds: local entrepreneurship that can keep the government from otherwise having to pay unemployment compensation, welfare, and the sundry other costs of plant closing. But such a program also threatens many interests. For example, companies like U.S. Steel don't want government-assisted competitors, even if they're tiny. This antipathy now has a sympathetic ear in the White House; the Reagan administration has effectively killed the EDA program despite the fact that almost all its beneficiaries, like Ladd's firm, are meeting their loan repayments.

A generous federal loan program to preserve low-return but otherwise healthy firms is only one step; changes in the tax code are also necessary. Workers and local investors wishing to buy an abandoned business are now at a disadvantage: they usually can offer only cash, on which the seller must pay income tax. Large corporations can offer a better deal: a tax-free exchange of stock. This motivation lay behind Lykes's decision to snub local investors and sell to Jones and Laughlin—which kept the Youngstown mill closed. These incentives should be reversed.

The new owners of these firms will need capital to keep their businesses modern and competitive. This is where union pension funds ($360 billion for AFL-CIO workers alone) can play an important role. Like Wall Street investors, trustees of these funds now are obliged to balance risk with expected return in pursuit of maximum gains. This means a firm promising "only" a four percent return will be passed over for safer and more profitable investments. The law should allow pension fund investment in such enterprises. After all, a union's priority should be preserving its members' jobs, not insisting on an extra $5 or $10 a month in pension checks.

Preventing premature deaths of healthy businesses also will require especially talented managers. Yet today the best graduates of our prestigious business schools usually shun "hands on" experience (particularly in "unglamourous" manufacturing industries) to become highly paid consultants who advise conglomerates to do such things as close low-return plants. Though the plush corporate headquarters of Stamford, Connecticut offer status and security, far more useful and challenging work lies in places like Youngstown, devising strategies that will save thousands of jobs, preserve community stability, and maintain consumer spending. Our corporate leaders shouldn't be throwing in the towel, but fighting back, and the effort to preserve low-return but profitable firms allows them to do just that.

Most important, the effort to resuscitate the nation's manufacturing base provides a perfect opportunity to promote the very essence of entrepreneurship: putting control of an enterprise in the hands of those with a real stake in its survival. However virtuous "public corporation" may sound, the notion is the bane of the low-return firm. Selling public stock subjects it to the dictates of outside investors, whose main purpose is not a factory's continued life but a sufficiently high return. Not so with privately held companies; to them, a one percent rate of return is perfectly tolerable if the owners know they're providing jobs and still making money. Encouraging private ownership should be the centerpiece of our efforts to save these businesses.

Those who doubt that saving them is worthwhile should pay a visit to any of the nation's industrial centers where unemployment is pushing 20 percent. More than just jobs are disappearing—so is a way of life. It's as if the post-World War II era were just an aberration in American history, a rare time when those whose "credentials" consisted mostly of a willingness to work hard could earn a decent wage. Today the choice such young adults face increasingly is between a high-paying manufacturing job they never can have and a $3.35-an-hour job cooking French fries.

Making the compromises necessary to prevent unnecessary business deaths will require a rare kind of leadership that won't be found among well-heeled corporate executives or politicians. It must come from the bottom up, from workers concerned about their children and the future of their communities, who believe that sacrificing some pay and benefits is worthwhile if it offers a better hope of keeping jobs that otherwise would disappear forever. And it will take leaders who, having known the assembly lines of Detroit, the blast furnaces of Pittsburgh, and the sawmills of the Pacific Northwest, believe there's something important in them that we can't afford to lose. ■

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1929 & 1982: THE SIMILARITIES

BY LOWELL K. DYSON

When the stock market went on its roller-coaster ride this fall, lots of people began referring to the Crash of 1929, but the consensus seems to be that it can't happen again. This isn't going to be another Great Depression, we're told. The situation is different, very different indeed.

Well, the truth is that those differences might not be enough. There are also a lot of similarities to the 1920s and 1930s, and the similarities are scary as hell. Consider the following:

SUPPLY-SIDE ECONOMICS. The father of supply-side economics is not Arthur Laffer but Andrew Mellon, who served as secretary of the treasury under Harding, Coolidge, and Hoover. Mellon believed that "a decrease in taxes causes an inspiration to trade and commerce," and he achieved his goal with the Revenue Act of 1926, which trimmed both the surtax on income tax and the estate tax to 20 percent, and eliminated the gift tax.

Under the Economic Recovery Act of 1981 pushed through by Ronald Reagan, the maximum capital gains was reduced to 20 percent, top taxes on unearned income to 50 percent, and estate taxes virtually eliminated.

WHO BENEFITS FROM THE TAX CUTS. In 1926, the major beneficiaries of the tax cuts were those in the upper 20 percent of all taxpayers.

In 1982, the *National Journal* reported that the top 20 percent of the nation's taxpayers reaped $36 billion in net tax benefits and that the rest of the population netted no tax savings at all.

WHO SUFFERS ANYWAY. The 1920s witnessed a precipitous decline in the fortunes of the people who had been the backbone of the American economy—farmers. The tax cut gave them nothing to improve their dwindling buying power, and farm income dropped by half in the late 1920s and early 1930s.

Similarly, in the last decade there has been the same kind of decline among those who had been the most recent backbone of our consumer economy—industrial workers. The Reagan tax cut gave them nothing to improve their dwindling buying power, and unemployment in manufacturing now stands at 14.1 percent.

In both cases, an important group of customers capable of leading a retail-sales recovery (which most economists agree is the quickest and most effective kind) found themselves in a depression.

WHERE THE MONEY DIDN'T GO. 1926, the year of the tax cut, was also the last year of real economic growth before the Depression. Construction, employment, wages, and salaries all reached their peak that year, and then—at the same time the tax cuts were taking effect—began a steady decline. The Jazz Age tax-cut recipients certainly didn't put their money into job creation and economic growth.

Today's decline began before the tax cut, but it hardly needs to be said that the money from tax cuts has not gone into productive investment. Just about any dismal economic indicator from this year will prove that.

WHERE THE MONEY MAY HAVE GONE. It's impossible to know for sure where people put their money when they pay less in taxes, but the suggestive evidence is strong. In the 1920s, a lot went into raccoon-skin coats and Duesenbergs, but a tremendous amount also went into the stock market.

Lowell Dyson is a Washington-area historian.

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In the early 1980s, the billions in tax breaks received by the wealthy were channeled not only into mink coats and Mercedes but into money markets as well. Last August, with the decline of interest rates, much of this money made its way into the stock market, fueling the surge in the fall.

WHAT'S WRONG WITH THAT? In 1929, there were two big problems with the investments people made in the stock market. First, the stock prices that resulted bore no relation to the true value of the stock, nor did they reflect what was going on in the rest of the economy. The *New York Times* stock index climbed from 176 in 1927 to a high of 452 on Labor Day, 1929, just before the Crash.

The second problem, of course, was that some 600,000 of the investors were buying on the "margin" (that is, borrowing up to 90 percent from their brokers). When the market headed down in October 1929, the "margin calls" began, and panic set in.

Whether the first of these conditions exists today is hard to figure, given that stocks have been undervalued in recent years. But the roller-coaster ride of recent months is not encouraging. "It's a real big gambling casino. It's gotten to be unbelievable," Jack Baker, chief stock trader of the First Boston Corporation, a big investment firm, recently told *The Los Angeles Times*. These same words have repeatedly been used to describe the climate of 1928 and 1929.

But, you say, the second cause of the Crash—buying on credit—no longer is a danger today because of margin requirements that 50 percent of a stock's price be paid up front. Yet while this is true for the stock market, it's not true for the topsy-turvy commodities market, and this year, for the first time, the two are directly connected.

The connection is something called "stock futures," which are traded like commodities, but instead of being pork bellies whose future price the investor bets on, they're stocks. Since this kind of trading was legalized in February of this year, volume has climbed to more than 30,000 contracts a day, which is already higher than all but a few commodities. Stock futures are simply exploding.

In so uncertain a time, the consequences are alarming. First, like all commodities, stock futures can be bought almost entirely on credit, which in itself could be a 1929-like margin problem if the business keeps growing. Second, and more pressing, there is, as Ron Hobson of the Commodities Futures Trading Commission says, some concern that the arbitrageurs who play both markets (betting on stock movements) could "transmit the volatility from one market to another." Increased margin-buying and more volatility, imported from the commodities market, should cast some doubt on the complacency of those who are so sure that conditions of 50 years ago cannot exist.

(If you want some confirmation of where the rich are now looking for action, consider a recent article in a new magazine called *Good Life*, which says it is targeted "exclusively for readers with high incomes." Commodities, the magazine gushed, are "the most emotional, exhilarating markets of them all.")

WHY RECOVERY IS HARD. The problem after 1929 was, quite simply, that too many people had too little money—and thus couldn't help spend the country back to health. Efforts to give them money—through relief—were paltry.

The assumption now is that our system of unemployment insurance will prevent this from happening. Today's employed not only suffer less, but have more to spend to keep the economy from stopping altogether.

While a major improvement, this isn't as reassuring as some imagine. As of October of this year, only 45 to 50 percent of Americans without jobs were receiving unemployment benefits, and as more benefits expire, the percentage will drop further. That compares to 68 percent at the depths of the 1975 recession. In other words, half the unemployed are suffering, really suffering. And not buying.

What's more, they may not be buying in the future, even if interest rates continue to fall. As Roger B. Smith, chairman of General Motors said recently to *The Washington Post*, "If a guy is going to go out there to buy a car, he's going to say, 'Boy, it's going to take me three years to pay for that. Am I going to have a job for three years? I don't want to go out there and default on my debt.' "

WHERE OTHER DANGERS LIE. The threat of defaulting on debt lingers over the world economy, too. In the 1920s, banks loaned heavily in international markets, particularly to Weimar Germany and Latin America. A wave of international defaults forced banks to call in delinquent domestic loans, triggering bankruptcies and foreclosures at home.

In 1982, U.S. banks are carrying $500 billion in outstanding loans, many of them on the brink of default. Fearful of that prospect, these banks are now lending even more money abroad, stretching the international monetary system to the breaking point. ■

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MEMO OF THE MONTH

MEMORANDUM

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
SOCIAL SECURITY ADMINISTRATION

TO : Mr. Larry Mason, Director
Executive Secretariat

DATE : AUG 23 1982

REPLY TO: SXP

FROM : James Brown
Press Officer

SUBJECT: Press Office Activities for Week of August 16 through August 20--
INFORMATION

UPCOMING NEWS, ACTIVITIES

Speeches

None

Meetings

None

Congressional Hearings

None

Media Interviews/Briefings/Press Conferences

None

Media Articles Prepared

None

Anticipated Press Releases

None

Anticipated Report Releases

None

Issue, Regulation and Decision Memoranda

None

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PRECARIOUS PROSPERITY:

BY JONATHAN ALTER

THE SIREN SONG OF THE SERVICE SECTOR

One thing that's clear from all the back-and-forth on the economy is that lots of people aren't letting themselves get too worried about the decline of manufacturing industries. A conspicuously large number of economists and thinkers are surprisingly confident about the future, and their confidence reflects faith in what is called the "service sector," which now accounts for seven out of every ten American jobs. The logic of the optimism suggests that factory closings, while painful, are really just part of an inevitable readjustment to a new, better, more competitive economy based on services and information.

The distinction between goods and services can be blurry, but it's important to keep the rough outlines in mind. Goods involve the production of things: cars, food, steel, oil, silicon chips. Services can supplement production—the computer mechanic who fixes the assembly unit, the wholesaler who brings food to market—but their aim is generally less to make items than to attend to them.

An even larger part of the service economy is attending to people, from waiting on them in restaurants, hotels, and department stores to caring for them in hospitals and doing their legal and accounting work. Then there is the supplying of information, preferably through the use of computers, which now seems to be the most glamorous part of the service industry.

In the U.S. the trend away from goods and toward the service sector is unquestionable. Between 1970 and 1978, the total American labor force grew only 18 percent, but the number of managers and administrators grew 58 percent; health administrators, 118 percent; public officials, 76 percent; bankers, 83 percent; and systems analysts, 84 percent. In 1980, for the first time, the Japanese, with an economy still half our size, produced more crude steel, more cars and trucks, and spent more on new factories, machines, and tools than we did.

The trend for the 1980s is clear. Projections by the Bureau of Labor Statistics show that the occupation with the largest percentage increase in the next ten years will be "paralegal personnel," which is expected to grow by a remarkable 108.9 percent. "Data processing machine mechanics" is just behind. Further down the list of top 20 growth jobs are food service workers, tax preparers, corrections officials, travel agents, nurse's aides, and, still in the top group, economists (a 42 percent increase), who presumably will keep us apprised of how the transformation is coming along. Engineers, by contrast, are not even on the charts. During the 1970s, they increased a paltry three percent.

One statistic from a labor department study illustrates the transformation in a particularly striking way. In an employment category called "eating and drinking places," the *increase* in employment since 1973 is greater than the *total* employment in the automobile and steel industries combined. Conventions have been another great growth area. According to the International Association of Convention and Visitor Bureaus, 43 million Americans—or one out of five—went overnight to a convention in 1981. The total number of conventions grew sixfold between 1970 and 1981, from 5,000 to almost 60,000. One of the most revealing figures is that the average stay for a convention is 3.8 nights, which means that, including travel time, a whole week of work can be consumed in colloquia, golfing, and other pleasures.

Jonathan Alter is an editor of The Washington Monthly.

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Is reliance on all this for the future strength of the U.S. economy sensible? A lot of respectable opinion apparently thinks so. Bill Moyers of CBS recently quoted with approval the words of James Robinson, president of Shearson/American Express, who gives speeches around the country touting the glorious future of the service and information age. And Sen. Gary Hart seems to agree. "The Information Revolution does not depend on finite resources such as iron, coal, copper, and oil, which powered the Industrial Revolution," Hart says. "It is driven by the inexhaustible ability to generate knowledge."

"It is important not to get depressed about the latest gloomy business statistics, which are strictly industrial-based measures of economic well-being," John Naisbitt writes in *Megatrends,* a new book that neatly summarizes all of the polly-annaish thinking on this subject. Echoing Daniel Bell's "post-industrial society," Naisbitt notes that "in an information society—for the first time in civilization—the game is people interacting with other people. This increases personal transactions geometrically; that is, all forms of interactive communication: telephone calls, checks written, memos, messages, letters, and more." What's so wonderful about all of this, he concludes, is that it will mean "an economy based on a strategic resource that is not only renewable but self-generating."

On Her Majesty's Service

Perhaps Robinson, Hart, and Naisbitt are right. Perhaps unemployed steel workers (or their children) can sit at computer terminals making American Express travel arrangements for a convention of paralegal personnel, systems analysts, and economists with a taste for McDonald's hamburgers.

Or is there a possibility, even conceding that the steelworker can adapt to the computer, that he will end up sitting at a terminal making reservations for a convention hall that is bankrupt? In other words, if everyone is in the service economy, who is going to be in the producing economy making the money to pay for the services? Must something more concrete, somewhere down the line, stand behind the services, assuring that they are at least vaguely redeemable in the production of a good?

Mark Twain, for one, thought so, observing once that no group of people can prosper "taking in each other's washing." And the experience of England is instructive. A hundred years ago, Britain ruled not only the seas but the world's service sector. Working for the Bank of England, Lloyds of London, and other mercantilist services seemed to the turn-of-the-century Englishman to hold a far more attractive future than managing one of the grimy steel mills of Birmingham.

But as Martin Weiner explains in *English Culture and the Decline of the Industrial Spirit, 1850-1980,* Britain's economic woes of recent years can in some ways be attributed to this growing sense that attractive, "clean" careers could somehow be disconnected from industrialization. What he calls the "gentrification of the industrialist" is instructive. Once young Englishmen lost interest in making things, the British lost their industrial base to the United States and Germany. And once that happened, its services also shriveled.

Mark Twain once observed that no group of people can prosper "taking in each other's washing."

In the last two decades, America's most highly talented college graduates also have tended to pursue careers—in finance, law, accounting, and so forth—where their hands have stayed clean and their lives have stayed unchallenged by entrepreneurial risk. Why have productive companies been so willing to pay for the enormous expansion of these services? In part because most company managers nowadays also prefer to avoid risk. They usually don't own the businesses they work for, which makes them fearful of making decisions that might upset shareholders or others to whom they are now accountable. The best way for the cautious manager to insulate himself is to contract out for consultants, legal counsel, and other services that can bolster his internal position. "Confronted with the choice between safety and maximum growth, the[y] . . . opted for safety," Weiner writes of our models in this matter, the British.

If Britain's service-sector dominance evaporated along with its industrial advantage, will the same thing happen to us? The evidence is not conclusive, but *The Wall Street Journal* reports a decline in the convention business this year, in some cases by as much as 50 percent. Indeed, *The Washington Post* says that the new Washington convention center, scheduled to open in early 1983

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and originally projected to increase the number of Washington visitors by 325,000, now expects only 110,000 conventioneers next year.

This is completely logical; unemployed autoworkers are going out to dinner less and strapped companies are making do with fewer consulting contracts. Consider the practice of law in Washington, D.C. After years of smugly assuming that the expansion of legal work was immune to anything but an earthquake at the corner of 17th and K Streets, many of the city's lawyers finally are learning just how dependent they are on their client's prosperity. If he suffers—at least if he suffers a lot—so do they.

All of this is not meant to suggest that the service sector has a dim future; on the contrary, services, particularly information suppliers, will continue to help employ people and bolster exports. But for the economy as a whole, the issue is the old eggs-in-one-basket problem. Too much reliance on any one asset can be dangerous.

When we became too dependent on OPEC for oil, they blackmailed us. Other countries or groups of countries we have come to depend on for manufactured goods may follow OPEC's example. This is a contingency we can ignore only at our peril. Other nations don't ignore it. Is it possible, for instance, that the Japanese determination to maintain some agricultural production is not simply a cynical sellout to a special-interest group but the reflection of something else as well? Perhaps it's a reasonable desire to preserve some measure of self-sufficiency, to avoid complete dependence on others.

The same point applies to national defense. No basic industry means eventually no capacity to threaten a long, conventional war. In the strange psychology of strategic doctrine, the only alternative might be a short war that does not put a strain on resources. Short wars, where few conventional weapons exist, are more likely to be nuclear. Again, the issue is flexibility.

Transactional Analysis

Perhaps the greatest danger of the service economy is the misleading sense of economic growth it gives. Executives of American Express tell congressional committees or anyone else who will listen that between 1967 and 1979 productivity in services increased twice as much as productivity in goods. But how is productivity in services measured?

Take banking, where productivity was once determined by the total volume of deposits on hand, thus reflecting how much capital the bank was helping form. Now productivity in that industry is being measured (by the Bureau of Labor Statistics) through a formula involving the total number of *transactions* completed.

The problem with this approach is that a transaction is neutral. A bank transaction, legal brief, clever tax return, or Telex message might aid economic growth; then again, it might not. Transactions do not distinguish between rearranging existing assets—re-slicing the economic pie, as Robert Reich puts it—and expanding the economic activity the country so desperately needs. A lawyer who drafts documents to smooth the way for the construction of a new building is aiding production; a lawyer who gums up the process in court for a client seeking paper profits is not. When a real estate broker makes possible the building of a new house, his service is productive; when he sells an old one, it isn't. Ditto a stockbroker with a new stock issue and a banker with commercial loans. Do their actions radiate growth out into the economy or just rearrange? The worth of particular services can be determined by the answer to that sometimes difficult question. But their "productivity" is measured without regard to that worth.

This is a disturbing development for American business, because to be socially and economically desirable, services should be a *genuine* adjunct to productive activity—computer-aided design, for instance, or a strategy that creates new business, or a loan for a new plant. When the goal (conscious or not) is simply to make money off paper transactions that don't create any new wealth for society, then we should rethink the worth of some of these services.

The point here is that placing too much faith in the potential of services and information might limit our productivity and flexibility in ways that many visionaries of the new age have not considered. Maybe Americans really can maintain their standards of living by writing memos and interfacing all day instead of making things. But the evidence of the last 15 years of economic performance—the same years that saw the rise of the service sector—suggests that it's too slim a reed on which to depend. The sooner we accept that reality and move to preserve and improve industrial capacity, the healthier our services—and our economy itself—will become. ■

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WHAT'S RIGHT WITH BIG BUSINESS

BY THOMAS J. PETERS & ROBERT H. WATERMAN, JR.

For the past three years, Thomas J. Peters, an independent consultant, and Robert H. Waterman Jr. of McKinsey & Co. have conducted an intensive study of several dozen of the nation's largest corporations. Their purpose was to identify those attributes shared by excellent companies—"excellent" defined here by such standard measures as a company's growth and its rate of return on shareholders' equity over a 20-year period.

The study's major conclusions should not surprise long-time readers of this magazine and others familiar with large institutions (public and private) and their enthusiasm for fatuous memo-writing, meaningless number games, never-ending task forces, and managerial featherbedding. Peters and Waterman discovered that the corporations that performed best over time were those that took great pains not to behave like typical bureaucracies. These companies encouraged innovation and risk-taking among their workers. They made concerted efforts to decentralize their operations and avoid traditional chains of command. They stressed action and experimentation rather than constant studies and playing it safe. In short, the companies that performed best acted least like large government bureaucracies—and far more like the small companies they once had been.

Obvious as this conclusion might sound, among American businesses such behavior is still the exception rather than the rule. In recent years, most corporate executives and business school graduates have embraced the bureaucrat's taste for strict quantitative analysis and an obsession with the bottom line. The result has been a preoccupation with short-term profits—at the expense of productivity, worker morale, and the long-term health of the entire economy.

Much as some might wish them away, large corporations have become a permanent part of American life. This study, portions of which are excerpted below, provides valuable lessons in how companies can be reformed for the benefit of not only their own employees and stockholders, but the entire nation's economy.

This article is adapted from In Search of Excellence: Lessons from America's Best-Run Companies, *by Thomas J. Peters and Robert H. Waterman, Jr., Harper & Row, publisher. Copyright © 1982 by Thomas J. Peters and Robert H. Waterman, Jr.*

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CHAMPIONS & ENTREPRENEURS

The most discouraging fact of big corporate life is the loss of what made it big in the first place: innovation. Even if big companies don't stop innovating entirely, their rate of innovation invariably goes way down. According to *Inc.* magazine, a National Science Foundation study found that "small firms produced about four times as many innovations per research and development dollar as medium-sized firms and 24 times as many as large firms." Studying the same subject, economist Burton Klein found that major firms are seldom if ever responsible for the major advances in their industries.

On the other hand, we have the excellent companies. They are big. They have enviable records of growth, innovation, and consequent wealth. Clearly, the odds are stacked against them, yet they foster innovation just the same. Perhaps the most important element of their enviable track record is an ability to be big and to act small at the same time.

A characteristic of such companies is the attention they pay to producing and nurturing potential innovators, also known as champions. To understand what champions are really like, we know no better source than *Sports Illustrated*'s discussion of Howard Head's long road to inventing the metal ski:

"In 1946 Head went off to Stowe, Vt. for his first attempt at skiing. 'I was humiliated and disgusted by how badly I skied,' he recalls, 'and, characteristically, I was inclined to blame it on the equipment, those long, clumsy, hickory skis. On my way home I heard myself boasting to an army officer beside me that I could make a better ski out of aircraft materials than could be made from wood.'

"Back at Martin [Aircraft Company], the cryptic doodles that began appearing on Head's drawing board inspired him to scavenge some aluminum from the plant scrap pile. In his off hours he set up shop on the second floor of a converted stable in an alley near his one-room basement flat. His idea was to make a 'metal sandwich' ski consisting of two layers of aluminum with plywood sidewalls and a center filling of honeycombed plastic.

"Needing pressure and heat to fuse the materials together, Head concocted a process that would have made Rube Goldberg proud. . . [H]e put the ski mold into a huge rubber bag and then pumped the air out through a tube attached to an old refrigerator compressor that was hooked up backward to produce suction. For heat, he welded together an iron, coffin-like tank, filled it with motor oil. . . and, using two Sears, Roebuck camp burners, cooked up a smelly 350-degree brew. Then he dumped the rubber bag with the ski mold inside into the tank of boiling oil and sat back like Julia Child waiting for her potato puffs to brown.

"Six weeks later, out of the stench and smoke, Head produced his first six pairs of skis and raced off to Stowe to have them tested by the pros. To gauge the ski's camber, an instructor stuck the end of one into the snow and flexed it. It broke. So, eventually, did all six pairs. 'Each time one of them broke,' says Head, 'something inside me snapped with it.'

"Instead of hanging up his rubber bag, Head quit Martin the day after New Year's 1948, took $6,000 in poker winnings he had stashed under his bed, and went to work in earnest. . . . [He] wrestled with his obsession through three agonizing winters. The refinements were several: steel edges for necessary bite, a plywood core for added strength, and a plastic running surface for smoother, ice-free, runs. One crisp day in 1950, Head stood in the bowl of Tuckerman's Ravine in New Hampshire and watched ski instructor Clif Taylor come skimming over the lip of the headwall, do a fishtail on the fall line and sweep into a long, graceful curve, swooshing to a stop in front of the beaming inventor.

" 'They're great, Mr. Head, just great.' At that moment, Head says, 'I knew deep inside I had it.' "

The presence of champions like Head is the single most important key to sustained innovative success in the excellent companies. We recently finished an analysis of the past 20 years' performance of a dozen or so major American and Japanese companies. One part was an in-depth study of 24 major business initiatives, such as GE's unsuccessful foray into computers and its success in engineered plastics and aircraft engines. In 15 of the 24 cases that were successful, 14 involved a clear champion. Of the nine failures, just three were champion-led. (Six either had no champion, or the champion left early and the project consequently fell apart.) To our surprise, the Japanese and American data matched. We had expected few champions in the purportedly more collectivist Japanese environment. Yet 100 percent (six out of six) Japanese successes had a champion, and three of the four Japanese failures had none.

Champions at Hitachi and GE? Yes, and at IBM too. James Brian Quinn, reviewing a quarter

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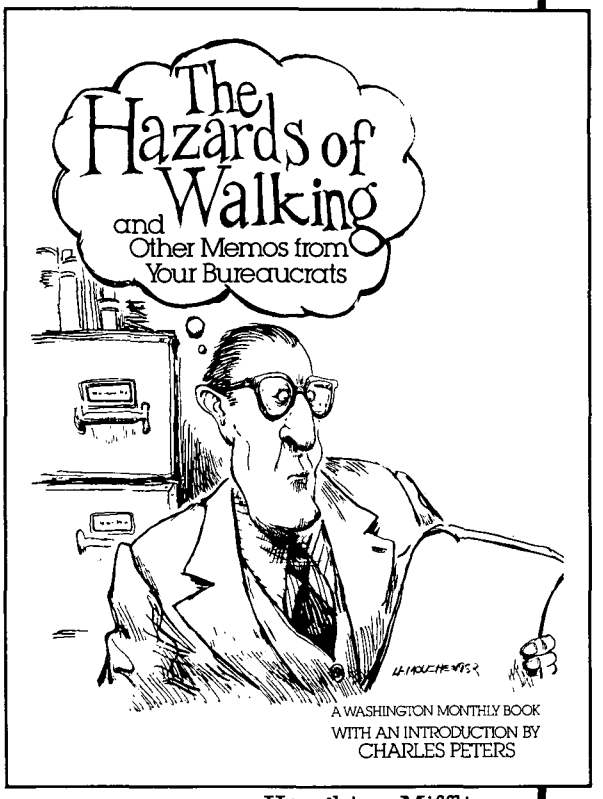

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Editor of The Washington Monthly

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century of IBM history, says: "It was difficult to find any successful major IBM innovation that derived directly from formal product planning rather than this championship process." An IBM executive in San Jose added, "When I look back over the last dozen products we've introduced, I find in well over half the instances the big development project that we 'bet on' via the system came a cropper somewhere along the way. In every instance—and I do mean *every*—there were two or three (about five once) other small projects, you know, four- to six-person groups, two people in one instance, who had been working on parallel technology or parallel development efforts. It had been with scrounged time and bodies. But that's a time-honored thing. We wink at it. It pays off. Looking at the projects where the initial bet failed, the subsequently developed project came in ahead of the original schedule in three instances. It's just amazing what a handful of dedicated people can do when they are really turned on."

"Do it," "fix it," "try it," are the by-words of successful companies.

Not surprisingly, most champions fail most of the time. How then do we reconcile repeated failure and overall success? Only one way: innovation success is a numbers game.

Suppose that a new initiative is launched and its odds of succeeding are only ten percent. If ten such initiatives are launched, the law of probability tells us that the odds that at least one thing will work go up to 65 percent. If 25 such initiatives are launched, the odds go up to more than 90 percent (the odds of at least two successes are almost 75 percent). The crystal-clear message is that no matter what the odds are of any one thing's working, the probability of something's succeeding is very high if you try lots of things.

The numbers game is most obvious in a business like oil. For instance, under chairman John Swearingen, Amoco has achieved a record of domestic oil exploration success that is at the top of the industry—better than Exxon, Arco, or Shell. The mainspring is simple numbers. A *Fortune* commentator notes: "The passion for exploration by whatever means are available sets Amoco sharply apart from the other majors. Exxon, for instance, rarely drills a well unless it owns the whole deal."

Champions are pioneers, and pioneers get shot at. The companies that get the most from champions, therefore, are those that have rich support networks so their pioneers will flourish. This point is so important it's hard to overstress. No support systems, no champions. No champions, no innovations.

One of the major support mechanisms is something often called "skunk works"—small bands of zealots off in the corner, often outproducing product development groups that number in the hundreds. At a $5-billion survey company, for example, three of the last five new-product introductions have come from a classic skunk works. The skunk works consists of eight to ten people and is located in a dingy second-floor loft six miles from the corporate headquarters. The technical genius is a fellow whose highest degree is a high-school equivalency diploma earned in the army in Korea (although the company has literally thousands of Ph.D. scientists and engineers on its payroll). The group's first product, now a $300 million per year sales item, was fully developed (prototyped) in 28 days.

Skunk works are notoriously pragmatic, as yet another vignette about this group shows. A major new machine was overheating. Teams of engineers wrestled with the problem for months. Finally it was decided to mount a one-ton air conditioner on the machine. One of the fellows from the skunk works happened by. He looked at the problem, then proceeded to the corner pharmacy to pick up an $8.95 household fan. It filled the bill, lowering the temperature sufficiently to fix the problem.

Champions don't emerge automatically. They emerge because history and numerous supports encourage them to, nurture them through trying times, celebrate their successes, and nurse them through occasional failures. But given the supports, the would-be champion population turns out to be enormous, certainly not limited to a handful of creative marvels.

The best imaginable reinforcement for all the major points we've made—champions, systems of championing, numbers of experiments, numerous and interlocking supports—can be found at the 3M company of St. Paul, Minnesota. Though 3M is one of the nation's corporate giants—with 1980 sales of $6.1 billion it ranked 51st on the *Fortune* 500 list—in many ways it's a company in which Howard Head would have felt at home.

3M's value system is specific in indicating that virtually *any* idea is okay. "Because of 3M's

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"We used to have 14,000 photos in the file, but not one of a supervisor listening to a worker," said Rene McPherson of the Dana Corporation.

diversity the conviction spreads easily that someone in 3M will be able to use almost anything," a commentator notes. The classic illustration of the point is the failed ribbon material that became a failed plastic cup for brassieres that became *the* standard U.S. worker safety mask after the advent of the Occupational Safety and Health Administration.

And failure is supported. Legend once more shows the way. Chairman Lewis Lehr recalls: "Shortly after World War II, we had a program to develop a bacterial skin barrier, called a surgical drape, for surgeons to use during surgery. The program was twice killed by senior management. [The ribbon-to-brassiere-to-face-mask champion was likewise told to knock it off. He ended up doing most of the product development work on the case at home.] But continued persistence ultimately produced a successful drape and led the way toward our $400-million-a-year health care business today. . . . We keep these stories alive and often repeat them so that any employee with an entrepreneurial spirit who feels discouraged, frustrated, and ineffective in a large organization knows that he or she is not the first to face considerable odds. . . . The freedom to persist, however, implies the freedom to do things wrong and to fail."

Perhaps most important is the user connection. The customer, especially the sophisticated customer, is a key participant in most successful experimenting processes. Much of the excellent companies' experimentation occurs in conjunction with a lead user. Digital has more inexpensive experiments going on than any of its competitors. (Hewlett Packard and Wang are close on Digitals's heels.) Each is *with* a user, *on* a user's premises. Many companies, on the other hand, wait until the perfect widget is designed and built before subjecting it—late in the game, often after millions of dollars have been spent—to customer scrutiny. The Digital, Hewlett Packard, and 3M magic is to let the user see it, test it, and reshape it—very early.

To help ensure that innovative ideas do not die prematurely, excellent companies pay attention to how and where their experiments begin. A colleague, Julian Fairfield, had as an early management job the problem of turning around a wire and cable plant that was performing miserably. "Everything was wrong," he said. "I didn't know where to start. So I started with housekeeping. It was the one thing everyone could agree on, and it was easy to fix. I figured if I became a fanatic on housekeeping, which was easy to improve, they would naturally begin to buy in to some other changes." They did.

"Do it, fix it, try it" seems to be the common operating principle among these companies. Robert Adams, head of R&D at 3M, puts it this way: "Our approach is to make a little, sell a little, make a little more." McDonald's has more experimental menu items, store formats, and pricing plans than any of its competitors. In our first three hours of interviewing at Dana, we heard mention of more than 60 different productivity experiments that were going on at one plant or another. P&G is especially well known for what one analyst calls its "testing fetish." Other examples from well-managed companies pour in daily. According to one analyst, "Bloomingdale's is the only large-volume retailer that experiments store-wide." In fact, in response to that observation, an employee from Levi Strauss who was attending a seminar piped up and said, "You know, that's where Levi got the faded jeans idea. Bloomie's was buying our jeans and bleaching them."

All this sets the whole notion of risk taking on its ear. It becomes risky in the excellent companies not to take a little risk, not to "step out and do a little something." The management task becomes one of nurturing good tries, allowing modest failures, labeling experiments after the fact as successes, leading the cheers, and quietly guiding the diffusion process. The experiment is at the very heart of a new approach to managing, even in the midst of the most staggering complexity at a 3M or IBM.

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SMALL IS PROFITABLE

In the excellent companies we studied, the emphasis on innovation and risk-taking was usually matched with a passion for simplicity. The desire for simplicity shows in the excellent company's penchant for small, streamlined operations. Indeed, for us, the story on plant size was nothing short of astonishing. Repeatedly, we found that the better performers had determined that their small plants, not their big ones, were most efficient. Emerson Electric is the best example. When Emerson was named as one of *Dun's Review*'s "best-managed companies," a simple success ingredient was highlighted: "Emerson rejects giant factories favored by such competitors as General Electric. Few Emerson plants employ more than 600 workers, a size at which Chairman Charles Knight feels that management can maintain personal contact with individual employees. 'We don't need a 5,000-person plant to get our costs down,' he says, 'and this gives us great flexibility.' Emerson puts heavy stress on those personal contacts with employees."

Another example of simplicity in form despite size is Johnson & Johnson. This company represents the extreme of keeping structure simple, divisionalized, and autonomous. J&J is a $5-billion company broken up into 150 independent divisions (up from 80 ten years ago), average size just over $30 million. The divisions are called "companies," and each is headed by a "chairman of the board." Even though none of the companies is truly independent in the sense of having stock of its own, the "boards of directors" are active and buffer the divisions from unwanted (and usually unneeded) corporate interference.

This flies in the face of conventional wisdom, which asserts that consumer market dominance requires large-scale activity. But chief executive James Burke observes, "We have periodically studied the economics of consolidation. There would be some dollar efficiencies on paper. But we believe that a lot of the efficiencies you are supposed to get from economies of scale are not real at all. They are elusive. Once you get your big monster going, you're going to create inefficiencies that you don't know are there. And if the management does see them, it won't be aggressive in rooting them out, because it doesn't have control of them."

The point of smallness is that it induces manageability and commitment. A manager really can understand something that is small and in which one central discipline prevails. More important, even in institutions that employ hundreds of thousands of people, if the divisions are small enough, or if there are other ways of *simulating autonomy,* the individual still counts and can stand out. Smallness works. Small *is* beautiful. The economic theorists may disagree, but the evidence of excellent companies is clear.

Along with smallness comes a lack of bureaucracy. We found less obvious structuring and certainly less layering in most of the excellent companies. Excessive layering may be the biggest problem of the slow-moving, rigid bureaucracy. It is done primarily to make places for more managers. If such layers exist, a kind of Parkinson's law of management structure sets in: extra levels of management create distracting work for others in order to justify their own existence. Everyone appears busy; but in reality it is simply management featherbedding.

photo courtesy of General Electric

Most of our excellent companies have comparatively few people at the corporate levels, and what staff there is tends to be out in the field solving problems rather than checking on things in the home office. The bottom line is fewer administrators, more operators. As a result, we coined our rough "rule of 100": With rare exception, there is seldom need for more than 100 people in the corporate headquarters.

Emerson Electric has 54,000 employees and makes do with fewer than 100 in corporate headquarters.

Dana employs 35,000 people and cut its corporate staff from about 500 in 1970 to around 100 today.

Schlumberger, the $6 billion diversified oil service company, runs its worldwide empire with a corporate staff of 90.

McDonald's numbers are similarly low, fol-

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lowing former chairman Ray Kroc's longstanding dictum: "I believe that 'less is more' in the case of corporate management." At $1 billion Intel, there is virtually *no* staff. All staff assignments are temporary ones given to line officers. At $2 billion Wal-Mart, founder Sam Walton says that he believes in the empty headquarters rule: "The key is to get into the stores and listen."

There is a related correlation in the kinds of slots—i.e., hierarchical levels—that the staffers fill. Decades ago Americans got hooked on the notion of optimal spans of control. We believe that no one can control more than five to seven people. The Japanese think this is nonsense. At one bank in Japan, several hundred branch managers report to the same person, proving that the flat organization *is* possible. One of the biggest contrasts between Japanese and American corporations, in fact, is in the number of middle-management levels. Whereas there are five levels between the chairman and the first-line supervisor at Toyota, Ford has over 15.

Now consider United Airlines's Ed Carlson's hourglass theory of middle management. In most organizations middle management really has little role beyond "makework" activities, such as stopping ideas coming down and stopping ideas going up. Middle managers, says Carlson, are a sponge. Hands-on management becomes a lot more workable when there are fewer people in the middle.

The numbers in many companies—both levels and employees—are staggering. Over the last 24 months, Ford, in an effort to become more competitive with the Japanese, has cut more than 26 percent of its middle-management staff; President Donald Petersen believes this is only the beginning. Reductions in the neighborhood of 50 percent, or even 75 percent, in levels and bodies are not uncommon targets when businessmen discuss what they honestly could do without.

With the distaste for bureaucracy comes far more emphasis on individual responsibility. The excellent companies have a deeply ingrained philosophy that says, in effect, "respect individuals," "let them stand out," "treat people as adults."

One of the most impressive success stories in people and productivity is that of the Dana Corporation under the leadership of Rene McPherson, now dean of the Stanford business school. Dana is a $3-billion corporation, making unexotic products like brass propeller blades and gearboxes, primarily supporting the unexciting secondary market in the automobile and trucking industry. If you had looked at Dana as a proposition in strategic management, you would undoubtedly have labeled it a loser. Yet in the 1970s,

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edited by Kent A. Price

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this old-fashioned midwestern business became the number two *Fortune* 500 company in total return to investors. In the early 1970s, the sales per employee at Dana were the same as the all-industry average. By the late 1970s, and without massive capital spending, Dana's sales per employee had tripled while the all-industry average had not even doubled, a phenomenal productivity record for a huge business in an otherwise uninteresting industry. Furthermore, Dana is largely unionized, with the United Auto Workers (UAW) in most of its plants. But during the same decade, its grievance rate fell to a tiny fraction of the overall UAW average.

photo courtesy of Dana Corporation

The key ingredient is productivity through people, pure and simple. When McPherson took over in 1973, one of his first acts was to destroy 22½ inches of policy manuals and substitute a simple one-page statement of philosophy. Says McPherson: "Almost every executive agrees that people are the most important asset. Yet almost none really lives it."

McPherson quickly reduced his corporate staff of 500 to 100 and the number of layers in his organization from eleven to five. His plant managers—about 90 of them—all became "store managers." In a litany repeated at Disney and Delta (where top executives often help handle luggage during the busy Christmas season), they were made responsible for learning *all* the jobs in the plants. And they were given the autonomy to get the overall job done. Their success led McPherson to say, in a statement that could get someone else kicked out of most board rooms in America, "I am opposed to the idea that less government, fewer regulations, capital formation incentives, and renewed research and development activity are what we need most to improve productivity. My suggestion: let our people get the job done."

McPherson is a bug on face-to-face communication and on discussing *all* the results with *all* of the people. He required that there be a monthly face-to-face meeting between division management and *every* member of the division to discuss specifically all of the corporate individual results in detail. (We see that time and again in the excellent companies. They are obsessed with sharing information and preventing secrecy. They willingly trade any marginal loss of competitive information for the added commitment.) McPherson has even stressed face-to-face contact in institutional advertisements. He has run ads that, as he says, "made many middle managers *very* nervous at first." One said: "Talk Back to the Boss"; another: "Ask Dumb Questions." McPherson deplores management's unwillingness to listen: "I wanted a picture, for a slide presentation, of a worker talking to his foreman. We had 14,000 photos in the file, but not one of a supervisor *listening* to a worker."

The major pressure at Dana—and it's a very real one, as in most of our other excellent companies—is peer pressure. Dana's effort to foster it is capped by Hell Week. Twice a year about a hundred managers get together for five days to swap results and productivity improvement stories. McPherson encourages the process, because he believes that peer pressure is what makes it all go. He says, "You can always fool the boss. I did. But you can't hide from your peers. They know what's really going on."

SERVING THE CONSTITUENTS

That a business ought to be close to its customers seems a benign enough message. Yet for all the lip service given this notion, far too often the customer is either ignored or considered a bloody nuisance.

A simple statement of what our research uncovered on the customer attribute is that the excellent companies *really are* close to their customers. Other companies talk about it; the excellent companies do it.

IBM is fanatic about its service beliefs. In most companies "assistant to" functionaries are usually bag carriers, paper shufflers, gofers. Not so at IBM. There, some of the best salesmen are made assistants to the company's top officers. While people are in this position, they spend their entire, typical three-year stint doing only one thing—*answering every customer complaint within 24 hours.* (In the field, the swarm effort is equally

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notable. A Lanier data-processing executive in Atlanta, a competitor in some areas, swears by IBM mainframes: "I remember the last time we had trouble. In hours the horde descended, from everywhere. They called in about eight experts on my problem. At least four were from Europe, one came from Canada, one from Latin America. That's just where they happened to be.")

Boeing is another excellent example. To be sure, the company manufactures airplanes, but what makes it outstanding is its service orientation. Says a *Wall Street Journal* analyst of Boeing: "Nearly every operator of Boeing aircraft has a story about the company's coming through in a pinch. When tiny Alaska Airlines needed landing gear that could put a jet down on a dirt strip, Boeing was there. When Air Canada had a problem with ice clogging in some air vents, Boeing flew its engineers to Vancouver, where they worked around the clock to solve the problem and minimize disruption of the airline's schedule."

photo courtesy of 3M

Perhaps our favorite example of service overkill is Frito-Lay. What is striking about Frito is not its brand-management system, which is solid, nor its advertising program, which is well done. What is striking is Frito's nearly 10,000-person sales force and its "99.5 percent service level." In practical terms, what does this mean? It means that Frito will do some things that in the short run clearly are uneconomic. It will spend several hundred dollars sending a truck to restock a store with a couple of $30 cartons of potato chips. You don't make money that way, it would seem. But the institution is filled with tales of salesmen braving extraordinary weather to deliver a box of potato chips or to help a store clean up after a hurricane or an accident. Letters about such acts pour into the Dallas headquarters. There is magic and symbolism about the service call that cannot be quantified. It is a cost analyst's dream target. You can always make a case for saving money by cutting back a percentage point or two. But Frito management, looking at market shares of 60 to 70 percent in most of the country and high profit margins, won't tamper with the zeal of the sales force.

The excellent companies are also better listeners. They get a benefit from market closeness that for us was truly unexpected—unexpected, that is, until you think about it. Most of their real innovation comes from the market.

Procter & Gamble was the first consumer goods company to put the toll-free 800 phone number on all its packaging. In its 1979 annual report, P&G says it got 200,000 calls on that 800 number, calls with customer ideas as well as complaints. P&G responded to every one of those calls and the calls were summarized monthly for board meetings. Insiders report that the 800 number is a major source of product improvement ideas.

There is surprising and powerful theoretical support for what P&G and others are doing. Eric von Hippel and James Utterback of MIT are longtime students of the innovation process. Not long ago von Hippel looked carefully at the source of innovation in the scientific instruments business. His conclusions: of eleven "first of type" major inventions he looked at, *all* came from users; of 66 "major improvements," 85 percent came from users; of 83 "minor improvements," about two-thirds came from users.

The best companies are pushed around by their customers, and they love it. Who at Levi Strauss invented the original Levi's jean? Nobody. In 1873, for $68 (the price for filing the patent application), Levi's obtained the right to market steel-riveted jeans from one of its users, Jacob Youphes, a Nevada buyer of Levi's denim. Almost all early IBM innovations, including the company's first computer, were developed in collaboration with its lead customer—the Census Bureau. When did 3M's Scotch Tape business take off? When a salesman, not the technical people, invented the handy desk-top dispenser for what had previously been a narrow-use industrial product.

So the excellent companies are not only better on service, quality, reliability, and finding a niche. They are also better listeners. That is the other half of the close-to-the-customer equation. The fact that these companies are so strong on quality, service, and the rest comes in large measure from paying attention to what customers want. From listening. From inviting the customer into the company. The customer is truly in a partnership with the effective companies, and vice versa. ■

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TIDBITS AND OUTRAGES

It's a Matter of Principal and Compounded Interest

The Chicago Bar Association recently issued a brochure entitled "Public Interest Litigation: A New Source of Income for the Private Bar."

According to *The Chicago Lawyer*, the brochure gushes over a $375,000 "pro bono" bounty in a recent case, adding, "Fees of this nature should whet the appetite of members of the private bar, especially in cases covered by 42 U.S.C. §1988 in which prevailing parties should receive fees and costs as a matter of course."

Score One for Watt

The Sierra Club recently placed an ad in *Advertising Age* for its new magazine, *Sierra*, asserting that "*Sierra* readers have very good taste. Each month, 81 percent serve domestic or imported wines, 27 percent serve bottled mineral water, and 42 percent offer their guest imported beer."

The Task Force's Findings Arrived Some Time Next Week

Subscribers to the government publication *Commerce Business Daily* had been complaining to the Government Printing Office about late delivery, so the Printing Office formed a task force in conjunction with the United States Postal Service to investigate. Here is the Printing Office's report to its customers:

"We deliver *Commerce Business Daily* to the Chicago Post Office by 3:30 p.m. each day, and the Chicago postmaster reports that the delivery pattern is fine in the USPS and we were told the USPS can do nothing to change it.

"Within 300 miles of Chicago, first-class and second-class mail will arrive in about the same time, 2 to 3 days. For customers in Los Angeles from Chicago, first-class mail generally takes 3 days and second-class 4 to 5 days. On occasion, the USPS has packages delivered in 2 days, but [illegible]

The Story on the Kitchen Cabinet Was Reassigned to Tom Brokaw

According to a reliable source, when a certain network anchorwoman was presented by her staff with a background book labeled "Gubernatorial Candidates," she snapped angrily, "I said I wanted the people running for governor."

Gubernor Deukmejian Proofed the Paper That Night

In a column five days before the election, Mary McGrory described Tom Bradley, the Democratic gubernatorial candidate in California, as having "an air of massive con."

The Washington Post ran a correction box a few days later noting that McGrory had intended "an air of massive calm."

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Give It To The Proles

by Corey Rosen

If you've traveled along the East Coast lately, you may have been a passenger on Peoples Express, one of the fastest growing—and most successful—young airlines in America. If you went camping, chances are good you were using something made of "Gore-Tex," a breathable yet water-resistant fabric coating made by W. L. Gore and Associates. If you've simply stuck close to home, then perhaps you've been breakfasting on Rath bacon, brought to you by Rath Packing Company.

Airplanes, raincoats, bacon—diverse as these products are, they all have one thing in common: they're made by companies that are owned in part by their employees. After just two years, Peoples's people own 33 percent of its stock; the average non-office-holding employee now has a $20,000 interest. President W. L. Gore boasts that his company has no employees—only 2,000 "associates," who own 95 percent of the company. Rath, number 499 on *Fortune*'s famous 500, is 60 percent owned by its employees, who purchased it three years ago to keep it from going out of business.

Of course, many employees own stock in their companies—5, 10, maybe 50 shares socked away in a safe deposit box somewhere. What's different about companies like Peoples Express, Gore, and Rath—and the 5,000 other U.S. businesses that have Employee Stock Ownership Plans (ESOPs)—is that *every* full-time employee owns a piece of the company. In about 500 of these companies employees own a majority of stock; in a few cases, they own the entire business.

If this idea seems like some strange ideological mutant—Marx's vision of worker ownership with a decidedly capitalist twist—it looks even stranger when you consider its progenitors. Lewis Kelso, a California investment banker, is generally credited with having cooked up the idea; his 1958 book extolling the idea was entitled *The Capitalist Manifesto*. Its greatest enthusiast in Congress is none other than Senator Russell Long, who is usually not renowned for his dedication to progressive taxation but nonetheless genuinely believes in the maxim "every man an owner," to paraphrase father Huey.

The plans usually work this way: A company contributes or purchases stock for employees and puts it in a special trust, crediting individual employees, on the basis of pay and length of service. The company gets a hefty tax break for the contribution, and the employees can take out their stock—often at appreciated values—when they leave the company.

What comes with ownership? Too much of the time, not enough. Many ESOPs, particularly those set up in the early days, are little more than tax dodges for companies that want to give favored employees tax-free benefits. Far more important, however, is that most ESOPs violate one of the most basic tenets of capitalism: those who "own" the capital have little or no control over it. This suits many managers just fine, such as Jack Lamp, the president of Arrow Metal Products Company. He recently told *Inc.* magazine, "Having the ESOP eventually become majority shareholder doesn't bother me as long as voting rights aren't involved."

This is a serious shortcoming. Why should workers worry about product quality when corporate executives can continue to make dumb decisions and award themselves bonuses even when the company is falling to pieces?

But it doesn't always have to be that way. At Peoples, employees make many of the decisions about how their jobs are organized, and non-flight jobs are rotated among self-managing crews. At W. L. Gore, the company's board is elected by the associates. And at Rath, the company is 100 percent controlled by its employees, who decide pay levels, where to invest their money, and how much to pay in dividends. Five years ago most

Corey Rosen is executive director of the National Center for Employee Ownership, in Arlington, Virginia.

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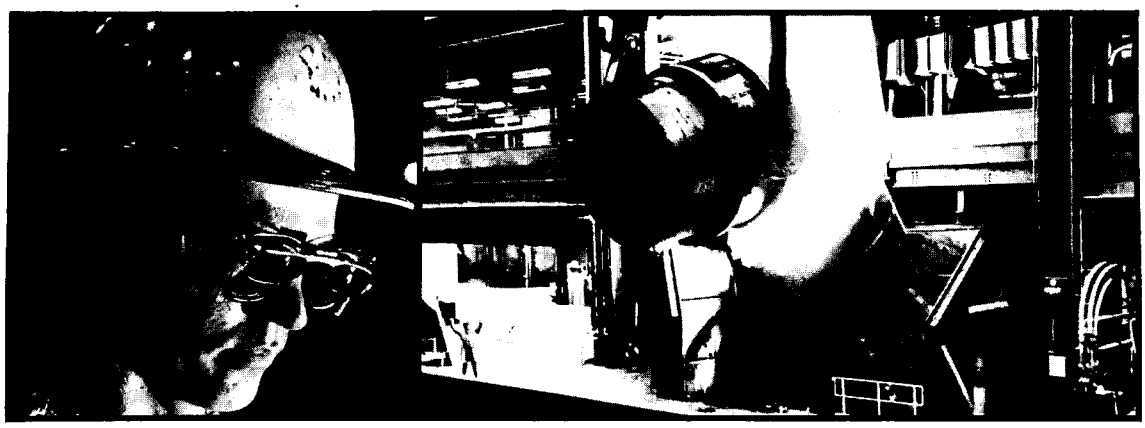

Photos courtesy of Weirton Steel

ESOP plans involved little more than giving employees stock; today, perhaps 25 to 30 percent give employees full voting rights on stock, and the number is growing.

This development not only is good for the employees, it's good for the economy. Though many people have heard of ESOPs in connection with efforts to rescue failing companies, only a few fall into this category. Not only are most ESOPs found in thriving businesses, but those businesses are far more profitable than their competitors.

If you've been expecting some verification from a study, here it is: In 1978, researchers at the University of Michigan's Institute for Social Research found that companies with ESOPs were 1.5 times as profitable as conventional companies in comparable fields. What's more, the ratio was directly related to the amount of equity the employees owned—the more they owned, the more profitable the company.

It doesn't take a behavioral psychologist to explain this; just think about how you'd feel about mowing your own lawn as opposed to mowing your neighbor's. The truth is, most jobs are rather routine if not boring, no matter how they're structured or how many "Work Smarter" signs dot the walls of the office cafeteria. But not surprisingly, employees in self-held companies are more motivated, they work harder, they innovate more, and when times get tough, employee-owners are more amenable to making sacrifices. After all, it's not only their jobs that are at stake but their companies as well.

Most business people intellectually agree that it makes sense for employees to have a financial stake in the company's success. But the next step, majority ownership and employee control, is quite another matter. The vast majority of corporate managers still believe they should make all the decisions while employees simply take orders and share the profits through wages and benefits.

Workers, and particularly the labor unions who represent them, have their own reservations about employee ownership. Unions fear that ESOPs will undermine their power, if not make them obsolete. A survey done at Harvard several years ago revealed that only one major union, the National Maritime Union, endorsed employee ownership.

Happily, this attitude seems to be changing. Chrysler workers will soon own at least 20 percent of that company, thanks to a requirement in the Chrysler Loan Guarantee Act that the company establish an ESOP. Railroad union leaders recently announced a plan to buy out the 50,000 employee Conrail Corporation, which the government will soon be putting up for sale, and the 8,000 employees of Weirton Steel in Weirton, West Virginia, are negotiating to buy the mill from National Steel in an effort to preserve their jobs.

For all the loose talk these days about the need for "economic democracy," ESOPs come closer than anything to realizing that ideal, which is in keeping with a long-forgotten tradition of American life. During the nation's first 100 years or so, economic policy was strongly motivated by a rather radical notion: wealth should be spread as evenly as possible, and everyone should have the opportunity to own a share. The abolition of primogeniture laws, the Reclamation Act, and the Homestead Act—the latter gave land free to people willing to work it—all were motivated by this ideal.

Industrialization gradually destroyed this broad-based ownership policy that, not incidentally, had helped create the most successful agricultural system in the world. But though the frontier may have vanished, opportunities remain for working men and women to feel they have a real stake in the nation's economic future. Let's seize them. ■

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WHO'S WHO in the Administration

When looking to see if **Ronald Reagan** will seek another term as president, try this very simple test: If **Michael Deaver** leaves the White House staff to return to his public relations firm, it will mean Reagan is not running; if he stays on, a good source says, odds are that Reagan is planning to stay on, too. Why does a decision by Deaver at this early stage mean so much? Because in public relations (and law, for that matter), you have to line up new clients while you still have the access they want to buy into. If you leave power at the same time as the president, you have a lot less to sell. Which means getting out early, unless, of course, you want to have to really hustle later on, like former Carter aide **Anne Wexler**. . . .

We've given you one explanation for why Defense Secretary **Caspar Weinberger** triumphed over Budget Director **David Stockman** and the entire OMB and White House staffs in convincing Reagan to stick to his huge defense budget increases (see "Tilting at Windmills," November 1982). But insiders tell us that there is another possibility: the charts on the easel. Clever bureaucrats have always known that the way to deal with the boss with the short attention span is to come up with some very simple flip-charts designed to dramatically appeal to the over-simplifications deeply embedded in the boss's mind. Weinberger has used this technique successfully twice in his battles against Stockman. This time, Stockman is planning his revenge. The only problem is the too-clever kid still doesn't understand how to deal with the old man. According to sources, Stockman has prepared 50 charts, when anyone who knows the president understands that four or five is his maximum.

In

WHITE HOUSE

Associate Director for National Security and International Affairs, Office of Management and Budget—**Alton G. Keel, Jr.**, was assistant secretary of the air force for research, development and logistics.

Member, Council of Economic Advisors—**William Poole VII** has been an economics professor at Brown University.

EDUCATION

Assistant Secretary for Postsecondary Education—**Edward M. Elmendorf** has been deputy assistant secretary for student financial assistance.

ENERGY

Secretary—**Donald P. Hodel** has been under secretary of the interior.

STATE

Assistant Secretary for Economics and Business Affairs—**Richard T. McCormack** has been a consultant to the department's bureau of economics and business affairs.

Assistant Secretary for East Asian and Pacific Affairs—**Paul D. Wolfowitz** has been director of the policy planning staff at the department.

Counselor—**Edward J. Derwinski** has been a congressman from Illinois.

Ambassador to the Bahamas—**Lev E. Dobriansky** has been an economics professor at Georgetown University.

Ambassador to Indonesia—**John H. Holdridge** has been assistant secretary of state for East Asian and Pacific affairs.

Ambassador to Mauritania—**Edward Lionel Peck** has been the director of the department's office of Egyptian affairs.

AGENCIES AND COMMISSIONS

Deputy Director, ACTION—**Betty M. Brake** has been deputy assistant director of the Older Americans Volunteer Program.

Member, Commodity Futures Trading Commission—**Fowler C. West** was staff director of the House committee on agriculture.

Out

WHITE HOUSE

Associate Director for Economics and Government, Office of Management and Budget—**Annelise G. Anderson** is expected to return to the Hoover Institute on War, Revolution and Peace early next year.

Special Assistant for Western States—**Morgan Mason** will return to his position as executive vice-president of Rogers & Cowan, a Beverly Hills public relations company.

EDUCATION

Assistant Secretary for Postsecondary Education—**Thomas P. Melady** has returned to his former post as president of Sacred Heart University in Bridgeport, Connecticut.

ENERGY

Secretary—**James B. Edwards** has resigned to become president of the Medical University of South Carolina.

STATE

Assistant Secretary for International Economic Policy—**Raymond Waldmann** is resigning.

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New Blood, New Hopes

By Michael Winerip

Illustration by Melodye Rosales

She was new, and had never been away from Haiti, so Danielle Lafond listened carefully to what the other Haitian women were saying about America. You will only go free, they told her, if you have a baby—that's how the other 20 got released. There is a new president, and this is his new rule.

As the months passed, the thought took over all others in the young woman's mind. She would run through it, sitting in the lobby of the run-down Miami Beach hotel where she was being held. The Golden Door, immigration authorities called the place—from the line in the Statue of Liberty poem. To Danielle Lafond it was prison.

She thought about why she had come, and that only increased the pressure to act. Her mother, a seamstress, had borrowed $800—an enormous sum in Haiti, where the average yearly income is $300—to pay the smuggler. Danielle, only 22, was to be the great hope of her family, the savior, the one who would get a job in America and send money home. She was a high school graduate and had worked as a factory supervisor in Haiti. She had not considered herself common, nor had others.

Michael Winerip covered immigration issues for The Miami Herald.

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Historically, people willing to bear great hardship to reach the United States have been a driving force behind economic growth. The Haitians fit this profile.

"I didn't come to this country to get pregnant," she says. "I have two kids in Haiti. I came to work. But it happened I was locked up and I had to get out, and getting pregnant was a way not to be deported. I knew quite well how to prevent being pregnant. I was looking on both sides of it, the dangers of being pregnant and the advantages of being released."

Men from Miami's Little Haiti had heard about the women who wanted to be free. They visited the Golden Door often. It was not a hard place to sneak into. Danielle Lafond began having "conversations" with a man she had known, but had never encouraged, back in Haiti. Her baby is due in two months.

The Golden Door women were right: the U.S. Immigration and Naturalization Service (INS) grants "humanitarian" paroles for pregnancy. In May, Danielle Lafond was let out.

Not so her traveling mates. The Haitian boat people—fleeing the poorest and one of the most repressive countries in the Western Hemisphere—have been the first group of refugees seeking political asylum to be detained without hope of being released on bond since Ellis Island was closed in 1954. After a 13-month legal battle 1,800 have been released from U.S. detention camps, but there is no guarantee they will be able to stay in the country. The Simpson-Mazzoli immigration reform bill currently pending in Congress will not help them, for this group came too late to be included in the bill's moratorium period.

And the Reagan administration certainly isn't going to help. Last year it decided detention would be a permanent part of this country's immigration policy and proceeded to spend $150 million turning temporary sites like Krome camp in Florida into permanent facilities, with higher barbed-wire fences, prison-style monitoring equipment, and recreation facilities. Bureau of Prison officials are replacing INS guards.

What are the qualities of the people being subjected to such treatment?

Richard A. Marshall, Jr., the assistant U.S. attorney defending the INS detention policy, resigned in December 1981, after several months of preparing the government case in support of detention. "I didn't want to be part of a situation of detaining a people who came that many miles, who wanted so bad to be here. I'm a sailor. I know what it's like. These people come without compasses. It's amazing." Peter Nimkoff, a former assistant U.S. attorney for the INS, declined a case two years ago because he could not bring himself to support the government decision to deny Haitians work permits.

Though the INS has done everything in its power to get rid of them, the Haitians have persevered. Even now, long after word of the detention camps has filtered back to Haiti, they keep coming, risking everything in their little boats. They bypass embassies, consuls, airport security. They just turn up on the beach one day. They have nothing but their wits to rely on.

To make his trip here Simon Salomon found an old boat and spent days on the Port-au-Prince docks figuring how big an engine he needed to reach Miami. He bartered for the engine, brought along 50 extra spark plugs, and organized his 42 passengers in such a way that not one knew any of the others—so no one could go to the Haitian secret police. Others have sold their small farms to raise the $800 to $1,200 needed to make the trip.

A number of Haitians want to get to America so badly they'll risk dying on the way. Twice in the last year small wooden boats broke up in stormy seas off Palm Beach, drowning 53. Others, crowded into hidden compartments for as long as two weeks, have dropped dead from dehydration just as they arrived on the beach. Women and children have drowned when smuggling captains, afraid of being caught with the evidence, have forced them into the sea.

There is, of course, a humanitarian reason for letting such immigrants in, but there is also a simple economic reason. Historically, people will-

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ing to brave such risks in order to make a better life, if not for themselves then for their children, have been the strength of the American economy. One can draw a distinction between the immigrant who simply steps across the border into Texas, or stays on after his student visa has expired, or lands at Kennedy Airport after a relaxing trip, and the immigrant who almost drowned or braved a hair-raising journey of thousands of miles.

This distinction does not solely reflect national origins. A Mexican who traveled hundreds of miles across rugged terrain and used his wits to survive qualifies. Nor should the amount of effort required to arrive in America be the only consideration. A future Einstein should be allowed to take the Concorde over if he wants to. But the distinction is a useful one nonetheless, and immigration policy should be flexible enough to take account of it.

The evidence of what grit and determination can mean comes not just from the early part of the century, when immigrants who had braved many hardships to get here helped build the country. It can be found today too. When New York Mayor Ed Koch was asked recently what he thought accounted for improved school test scores, he said the new immigrants—the Latin Americans and Africans who work hard and care about their neighborhoods and families.

The Haitians fit this profile. As did their predecessors, they likely would start out in the ghetto, working the jobs no one else wants, living through their children. Eventually, when the spirit and industriousness and love of America bears fruit, they would, for the most part, become a driving force behind economic growth. They would, that is, if we gave them the chance.

Model Prisoners

What's so perverse is that the Haitians—who symbolize everything we should want from an immigrant group—are treated much worse than other immigrants. Unlike Poles or Soviet Jews or Cuban refugees, Haitians are fleeing a country the U.S. calls an ally. This means the government will not give most Haitians official "refugee" status, and they are considered illegal immigrants.

Only once, in 1980, for a few months under President Carter, were Haitians designated legal entrants. But the primary reason for that circumstance was not the Haitians but the 125,000 Cubans allowed by Castro to leave the port of Mariel. When the immigration restrictions were eased temporarily for the Cubans, some Haitians gained entry as well. But the policy changed in the summer of 1981, and under Reagan's tough immigration stance, 1,800 Haitians were locked away in American detention camps for up to a year while INS considered their asylum claims.

While the Cubans have contributed heavily to a rising crime rate in Miami, the Haitians have committed very few crimes. In fact, these mostly rural boat people have impressed even their jailers with their law-abiding ways. Cecilio Ruiz, until recently director of the Krome camp, says he was so short of staff last year—at one point he had 26 guards for 1,000 Haitians—that it would have been impossible to run an orderly transition if the Haitians weren't so cooperative. "They're not an aggressive people," Ruiz says. During their detention, there have been no rapes, no homosexual attacks, no muggings—none of the behavior that characterized some of the Cubans who came on the Mariel boatlift (see "Castro's Revenge," March 1982). Of all Miami's ethnic neighborhoods, Little Haiti—population 500,000—has the lowest crime rate.

Moreover, like almost all illegal immigrants, the Haitians give the United States government much more than they get back. This is contrary to the public's incorrect perception that aliens come to this country and become wards of the state. In truth, illegal immigrants who are working—a large percentage—have taxes withheld from their paychecks. Meanwhile, few register to become eligible for welfare or other government benefits for fear of being discovered. Immigrants are hardly the drag on society many believe them to be.

Do they take jobs away from Americans? Sometimes, but many jobs are so menial and so low paying that Americans won't take them—or stay in them. A small window-frame manufacturer in Houston, for instance, was raided this spring by the INS, and 92 jobs held by illegal aliens were opened up to Americans. Two months later, INS went back for a follow-up inspection and 68 of the Americans had already quit. It's unfortunate, but this pattern of turnover in menial jobs, while lessened somewhat by the recession, exists throughout the country. There doesn't seem to be much reason why people willing to work the longest and hardest at these jobs shouldn't get a crack at them. When it comes to Haitians, though, they usually don't.

Apart From Poles

Romer St. Jilles and his wife, Lillian, were in Krome for over a year, separated by three barbed-wire fences. They were not allowed to visit each other. "We had to yell through the fences," said the

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husband. "It was hard to talk about anything personal," said the wife.

"I would like to keep my head up," says Jean-Claude Dominique, who suffered a nervous breakdown during asylum hearings. "I just can't. It's not my fault. I keep thinking I have five children, two brothers, a wife, a mother, two sisters in Haiti. They're all depending on me. I'm the oldest."

The plain truth is that the government is not required to treat aliens with anything approaching evenhandedness. "Congress regularly makes rules [for aliens] that would be unacceptable if applied to citizens," the U.S. Court of Appeals for the second circuit noted in a June 1982 opinion. In that case the appeals court ruled that the government had not, in fact, discriminated by detaining 53 Haitians while releasing most non-Haitians from the INS Processing Center in Brooklyn.

Nor did U.S. District Judge Eugene Spellman, who ordered the June release of the 1,800 detainees, feel the Haitians' lawyers had proved legal discrimination in their case. However, Judge Spellman did agree that more Haitians were detained for longer periods of time than non-Haitians. "Haitians are being impacted by the detention policy to a greater degree," he wrote. A city of Miami worker testified in the same case that she took a Haitian to Miami's INS office one day that summer and found Cubans waiting inside while Haitians stood in the hot sun in back of the building. "There was a sign. It said, 'Haitians to the rear.' "

The Reagan administration says it has not singled out the Haitians or treated them differently from any other undocumented aliens. The government says it created a policy that happened to affect so many Haitians because that's who was coming to this country at the time.

Yet the Haitians have not been the only nationality coming into the U.S. recently in significant numbers who fall into the non-bondable category. (U.S. immigration policy distinguishes between those refugees apprehended at their points of entry and those caught elsewhere after their arrival in the country. Only the latter are eligible for release on bond, pending an asylum hearing.) Poles also do. But Poles have been freed immediately. They have been given a special "extended voluntary departure status" by INS.

A smaller group of Nicaraguans also fits this special category. Attorneys Robert Boyer of Miami and Lisa Brodyaga of Los Fresnos, Texas, represented 35 undocumented Nicaraguans entering this country during the same period the INS detained undocumented Haitians. The Nicaraguans were released. "They were fleeing a leftist Sandinista government," says Brodyaga, "so of course the INS looked favorably on their chance for asylum. It's good propaganda."

"When the government decides it wants to get tough on immigration," says Ira Kurzban, a Miami attorney who has represented Haitians for several years, "it always draws the line with Haitians. The government cannot and will not address the most substantive immigration problem—the Mexicans—because agribusiness needs cheap labor and we need Mexican oil. And the Mexicans have a constituency here. You don't want a get-tough policy against a group that might cause you internal problems. So what do you do if you want to show how tough you can be? You pick on a group that it is not numerous. You pick on the Haitians."

During a 1980 lawsuit, U.S. District Court Judge James King discovered the INS's method for keeping track of Haitian asylum cases. The INS judges placed a check mark in the "asylum denied" column. There was no "asylum granted" column.

A Suffering Standard

The Haitians don't fit the economic profile that has characterized other groups that have gained refugee status from the U.S. government. Only five percent of Haitian boat people have held white-collar jobs, compared with a third of the Hungarian immigrants in recent years, half the Indochinese, and two thirds of the Soviet Jews and Cubans. Immigration statutes are designed to favor people with specialized skills, even if those skills entail nothing more than an earlier career as a bureaucrat.

Aside from betraying an implicit elitism (imagine if at the turn of the century the U.S. had allowed only burghers and no peasants), it is not the most economically sensible way to distinguish between immigrant groups. Again, the best way to do that is also the most natural—to make it hard to immigrate, but to reward with freedom those most willing to suffer for the privilege.

If that is not a specific policy prescription, it should at least suggest the short-sightedness of the U.S. policy toward Haitian refugees. Skills can be acquired. What can't be—what must come over on the boat—is the determination for a better life that has always been the secret of American success, economic or otherwise. To thwart that desire, especially one that burns so intensely, harms not only the immigrants, but the rest of us. ■

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FINALLY A GOP JOBS PROGRAM

by Art Levine

To: James Baker, Chief of Staff
From: Martin Feldstein, Chairman, Council of Economic Advisors
Re: A Marshall Plan for the Townships

The unemployment issue undermined us more than we forecasted in the mid-term elections, convincing me that we must facilitate a more sound approach for the near-term future.

I'll be candid, Jim. We need to do something soon, and I've reluctantly come to the conclusion that a jobs program is the only answer. I know that sounds irresponsible, and that the President has ruled out such "quick fixes," but bear with me for a moment.

As you know, the liberals have heavily impacted the electorate with their "infrastructure" proposal, which proposes to put the able-bodied unemployed to work fixing roads, bridges, dams, parks, and so forth. This isn't our constituency (see the RNC's recent polling report, *People Who Shouldn't Vote,* November 1982), but I think we need to consider how to adapt the idea to our private sector initiative proposals.

My staff has assembled a Presidential Review Memorandum on the subject based on some research conducted by Muffie Brandon. Although she has generally been pigeonholed as the First Lady's social secretary, I've been favorably impressed by the quality of her economic insights.

Among Dr. Brandon's disturbing findings after a recent inspection tour of Grosse Point, Palm Springs, and Newport are the following:

—5,000 miles of private driveways are filled with potholes. (The added cost for health spa retreats resulting from these bumpy rides is conservatively estimated at $42 million a year—money that would otherwise be invested in polo ponies, art, and other job-creating ventures.)

—800,000 maid and butler positions remain unfilled because of a shortage of "good help," forcing many of the country's most productive citizens to plump their own pillows.

—843 of the nation's finest country clubs are crumbling from neglect. The grass on some putting greens has grown to a startling two inches, a full one and a half inches above recommended length, severely threatening the peace of mind of America's most important executives; the base lines of 10,500 tennis courts around the country have not been painted for over a year (this doesn't *include private courts).*

—America's most vital ports—the private docks adjoining yachting clubs and seaside mansions—are virtually collapsing.

After conferring with the President's other top economic advisers, my policy recommendation is a full-scale jobs program to ameliorate these conditions.

Unfortunately, the President's policy preference—a jobs program with no salaries paid to the workers—is unavoidably unviable. Fred Fielding over in the White House counsel's office tells me we might have a problem with the Thirteenth Amendment on this one. His legal staff reads the language as prohibiting involuntary servitude.

A workable alternative would be to pay the workers we hire a minimal wage, say $1 an hour, which could be funded by charity balls. In addition to the compensation, workers would get a new sense of pride knowing they're helping captains of industry put the economy back in shape. David Gergen in the press office has suggested that for political purposes we change the administration's slogan from the grim "Stay the Course" to the more upbeat "Fix the Courses."

Art Levine is a contributing editor of The Washington Monthly.

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This approach is not some liberal-style indiscriminate giveaway. One of my own pet policy prescriptions is to strictly target the program to help those who need it. Potential recipients of help at the club or at home will be subjected to a rigid "means test"—only people of means will be eligible.

According to an unpublished study by one of my Ph.D. students, *The Demographics of Investment: Squash Players and the Revitalization of America,* the most productive people in the economy in terms of capital formation and investment are professionals and corporate executives who make between $150,000 and $400,000 a year. The tax cuts contained in the President's Economic Recovery Program last year take care of the people above that income level, and the people below are irrelevant to the prosperity we all seek.

Complementing these elements of the program should be an aggressive training initiative. Our vocational education classes are hopelessly outdated, concentrating on auto mechanics and woodworking instead of the burgeoning service-sector skills: doormen, chauffeurs, maids, butlers, and nannies.

A consultant hired by the Department of Education recently completed a 600-page study recommending that the training program take a lead from the Pullman porters of earlier years and rename all of the minority students "George." However, Kenneth Duberstein in Congressional Liaison has red-flagged a potential problem here, noting that Senator Helms prefers the name "Fred."

If the President approves the plan, our timetable could get it geared up for implementation shortly after the end of the hunt season. ■

A JOB

We soon will have an opening for a reporter-editor. Desirable qualifications include practical experience working in or writing about politics and government. More important are intelligence, humor, and the willingness to work long hours for low pay. Applications should be accompanied by a list of at least three references, and by writing samples, not necessarily published but designed to demonstrate fact-gathering and analytical ability.

The Washington Monthly

THE WASHINGTON MONTHLY

Journalism Award

for September 1982 is presented to

Timothy Egan
The Seattle Post-Intelligencer

This story investigates the oft-overlooked world of banking to reveal how the trust department of a leading Seattle bank sold its client's property at a fraction of its apparent value, without his knowledge and in an apparent effort to prevent a rival bank from obtaining it.

Loretta Tofani
The Washington Post

This remarkable series documents the epidemic of homosexual rape in the Prince Georges County Jail in Maryland. Tofani shows how official negligence and a policy of locking up violent offenders together with non-violent ones makes modern-day prison life far more horrifying than most imagine.

The Washington Monthly wishes to recognize the writers and publishers who share our purpose of trying to describe how the political system really works, to determine why it succeeds, and why it fails, and to suggest ways in which it might be improved.

The **Monthly Journalism Award** is presented each month to the best newspaper or magazine article (or series of articles) on our political system. Nominations from any newspaper or magazine in the country are welcome. The subject can be government in its federal, state, or municipal manifestation.

The award for articles published in November will be announced in the February issue. Nominations will close December 15. Nominations should be accompanied by two copies of the article or articles.

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James Fallows
ON POLITICAL BOOKS

Early in the Carter administration, when I was working on the president's staff, I encountered the strangest of many strange apparitions in the White House Mess. Amid the Filipino stewards, who moved silently with deferential smiles, there stood one dwarfish figure, its head draped with white flaxen hair. When the figure turned, I could see that it was not Miss Lillian Carter, as I had initially supposed, but Andy Warhol. Andy Warhol! What had happened to the rules? Wasn't the White House the pinnacle of the staid institutions Warhol had been satirizing all along? I was so confused by the incongruity of the moment—to my eyes, even the Coptic Pope had looked more natural in the White House—that I overlooked a semi-logical explanation. Warhol had recently produced a popular poster of Jimmy Carter; perhaps he merely was being honored as a loyal Democrat.

Had *Edie** existed then, I might have guessed at another explanation, and I might have avoided a later moment of confusion when I learned that Warhol now was dining with the Reagan family in the White House.

This reminiscence of a burned-out case from the Sixties, with its side view of Andy Warhol and the Pop culture he personified, has been this fall's publishing phenomenon, as Diana Trilling's *Mrs. Harris* was last year's. The subtext of both books concerns the tensions and delineations of class. In *Mrs. Harris*, the principal tension was between the author and her subjects, whose social pretensions she found unseemly. (The very recipes in Dr. Tarnower's Scarsdale Diet cookbook reeked of the parvenu.) One of the themes of *Edie* is the way two apparently opposite kinds of status managed to feed on and fool each other. Edie Sedgwick became a momentary celebrity by becoming the mascot of the drugged/artistic/homosexual/outre culture of Warhol's Factory; but these same glitter stars seemed to take Edie's family-name/old-money brand of status as seriously as she took theirs. The first hundred-odd pages of the book are dedicated to establishing that Edie Sedgwick did in fact come from what most people understand as the "upper class." She had looks and money; more important, she had a good family name.

She was from that John Marquand world in which money had not been earned in any identifiable way, but simply *was* in the family. Her family had its own cemetery, the famous Sedgwick Pie, in which descendants were laid out like slices around the patriarch in the center, so on judgment day they could rise and see no one but kin. Edie's renegade branch of the family broke off from Massachusetts to live in California, where her father engaged in leisured deviance and discussed whether or not certain members of the local society were "out of the top drawer." His friends were shocked "because he took up with a young married woman. . . from a first-generation Catholic background." He left his children with psychological burdens that give the book its air of melodrama. He also seems to have given them a dash of the aristocratic anti-Semitism that was a traditional staple of high WASP culture. (Edie to a friend in New York: "Cheap kike. . . . You rotten kike, you cheap bastard, Jew mother-fucker, small-time entrepreneur!")

Her background could hardly be more different from that of Andy Warhol, who had been raised in an immigrant family outside Pittsburgh and had gone to Carnegie Tech. Warhol had his eye on bigger things. "I think, looking back, that at a very early age [Warhol] had decided what it was he wanted: fame—that is, to be a famous person," says Truman Capote, from whom such judgments carry weight. "His drive was simply that: fame was the name of the game. . . not really talent." Or, Jasper Johns expressed an equivalent yearning: "When I was growing up, I knew I wanted to be an artist. It meant being an interesting person who was doing interesting things to which people paid attention, and not being who I was at the time—someone living in a little town in South Carolina."

James Fallows is Washington editor of The Atlantic *and a contributing editor of* The Washington Monthly.

**Edie: An American Biography*. Jean Stein with George Plimpton. Knopf, $16.95.

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Although Warhol's celebrity took the form of startling the bourgeoisie, *Edie* makes clear that he and others were seduced by the respectability that a tarnished aristocrat like Edie could confer. "Edie was always brilliantly late," one Rene Ricard says. "Andy would wait for her; he'd never say a word. He trusted her aristocratic instincts. He always said, 'She knows what she's doing.'" "Andy wanted to be in her immediate past, her rich, powerful, Waspy past," says another Factory figure. "When Edie entered the Factory scene, I thought it was nice that the Cambridge boys had imported their own private princess." Edie's rivals for Warhol's attention included "a group of boys from the Cuban aristocracy. . . . The Duchess of Rothschild would come trotting through with all these fabulous people, the rich, the beautiful. . . ."

Edie played her assigned role of princess for all it was worth. Out of cash, she paid a New York cabbie with a pearl-and-diamond ring. She went slumming on the one subway trip of her life, wearing a velvet evening gown cut to mini length and an ostrich-plume coat. She wowed the commoners by wearing the same outfit to Coney Island. She met a group of outlaw bikers and greeted them with fluttery cheek kisses, Hollywood style. One said, "You can't go around kissing bikers on both cheeks like she was kissing them. Ordinarily they'd 'turn her out' [rape her] right on the spot. . . . Edie figured, I guess, it couldn't happen to her because she was different."

By the end, it was far from glamorous, and *Edie* describes enough unsavory behavior to embarrass all sides. (Told that Edie was dead, Warhol asked a question or two and then "continued with something like, Well, what have *you* been doing?" What did he need with mere princesses, when he had presidents in his future?) Yet the contents of the book—and its wild popularity—say something about the taste for aristocratic glamour in many of our democratic souls.

One group, of course, is exempt. The policy-minded worthies of Washington can console themselves that they are free of the status hungers that drive artistic degenerates like Warhol. Conservatives can say that as they pick up William F. Buckley's magazine; old-style liberals as they dress for the next Progressive PAC discussion group at Pamela Harriman's house; and "Atari liberals" as they watch George Plimpton selling computer games on TV. ■

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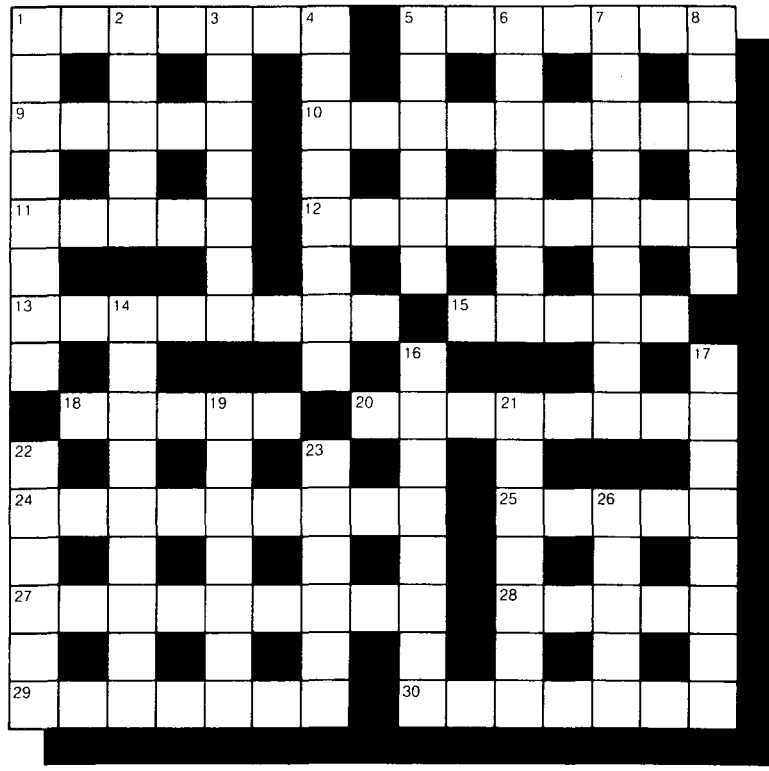
POLITICAL PUZZLE



by John Barclay

The numbers indicate the number of letters and words, e.g., (2,3) means a two-letter word followed by a three-letter word. Groups of letters, e.g., USA, are treated as one word.

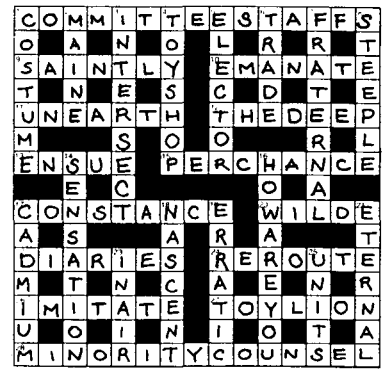
ACROSS

1. The last of company enlarged. (3,4)
5. The end of little government expanded. (7)
9. Pickpocket flourishes if the confusion continues. (5)
10. Essential for organizing ray scenes. (9)
11. Size causing difficulty in wardrobe selection process. (5)
12. How they spell "relief" in Canton, state. (9)
13. "Without music life would be ____" Niezsche. (1, 7)
15. Minimum stale mixture. (5)
18. Movement coming off the sauce. (5)
20. Get back, *i.e.*, revert in a way. (8)
24. Passes destination in bad tire? (2,3,4)
25. Follows Ann in Midwest. (5)
27. Skeptic's comment on arranging soya shows. (3,4,2)
28. Bell charges? (5)
29. Start of garrison state developed. (7)
30. Center of rifles blown up. (7)

DOWN

1. Organized anti-loan league. (8)
2. Justice before the house. (5)
3. Wandering cops rather different? (3-4)
4. Lucky in the end getting bigger. (8)
5. Two guys fall prey to crime. (6)
6. Clarify, about 1 or 5 Across, for example. (7)
7. Where some candidates are found on both sides. (2,2,5)
8. Irksome, tiny, little gross assortment. (6)
14. Unsuccessful party line. (1,4,2,2)
16. Repels 3 Down before 1st of September switched. (5,3)
17. Sinbad in the middle stretched. (8)
19. Affair which makes woman explode? (7)
21. Respond from tot care arrangement. (5,2)
22. Signal from hair joker? (6)
23. Half the flak exploded. (6)
26. Lawyer with casus. (5)

Answers to last month's puzzle:



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POLITICAL BOOKNOTES

The Case for Bureaucracy. *Charles T. Goodsell. Chatham House, $8.95.*

The Case for Gold. *Rep. Ron Paul, Lewis Lehrman. Cato Institute, $8.95.*

The Complete Reagan Diet. *Jeff Danziger. William Morrow, $2.95.*

Corporate Liberalism: The Origins of Modern Political Theory, 1890-1920. *R. Jeffrey Lustig. Univ. of California, $25.00.*

Eugene V. Debs: Citizen and Socialist. *Nick Salvatore. Univ. of Illinois, $24.95.*

Fear at Work: Job Blackmail, Labor and the Environment. *Richard Kazis, Richard L. Grossman. Pilgrim Press, $10.95.* An original and much-needed book that may not get the credit it deserves. Kazis and Grossman present a catalog of evidence that environmental regulations are not the crushing burden some businessmen have claimed, and the Reagan administration assumed. They show, through numerous examples, that factories said to be shut down because of anti-pollution rules usually were scheduled to close for some other reason, the most common being age. "The tenth annual McGraw-Hill Survey on Pollution Control Expenditures," the authors write, citing a study taken by businessmen for businessmen, "reported that corporate executives in the nation's major industries attributed less than one percent of plant capacity shut down during the years 1976-78 to environmental and safety regulation. In more recent surveys McGraw-Hill stopped asking executives about environmentally related shut downs and job loss. There was not enough response to warrant continuing the question."

The book is likely to meet a cool reception because its authors work for Environmentalists for Full Employment, a union-related outfit, and pad their otherwise carefully analytical book with canned labor Muzak. (William Winpisinger, for instance, is quoted worshipfully, and often.) Equally important, Kazis and Grossman, after showing big business's claims about the burdensome nature of environmental regulation to be greatly exaggerated, never suggest *why* businessmen grew so bitter about pollution rules in the first place.

I suspect businessmen grew furious over environmental regulations themselves, but only because they were the last straw. Here our valiant executive was, after all, doing battle with the other economic menaces of modern times—foreign competition, fuel prices, interest rates—and along comes government to add an extra task. Because environmental regulation seemed, to some businessmen, a luxury rather than a necessity of health, and because unlike all the uncontrollable forces of world economics it was something businessmen could attack directly using the political machinery, our nation's executives focused all their energy and visceral anger on government rules.

However short-sighted, it is understandable. And perhaps it helps explain the economic tailspin of the 1970s. When business executives should have been working on their *real* problems—competition and innovations—instead they spent their time feeling sorry for themselves over what Kazis and Grossman have shown to be a false problem. Business was busy complaining and begging Washington for relief, while Japan was busy stealing markets.

—*Gregg Easterbrook*

God's Bullies: Power Politics and Religious Tyranny. *Perry Deane Young. Holt, Rinehart, $13.50.* Yes, *God's Bullies* is the book that says NCPAC's Terry Dolan is gay. But Young's book is more than just gossip and isn't the alarmist reaction to the New Right we are used to seeing. It exposes the hypocrisy of New Right leaders and ideas in an engagingly personal, funny, and thought-provoking way.

—*Tina Rosenberg*

Holy Terror: The Fundamentalist War on America's Freedoms in Religion, Politics and Our Private Lives. *Flo Conway, Jim Siegelman. Doubleday, $17.95.* The authors of a previous book on cult religions now attempt to reduce born-again Christianity to that status. Never mind the Moral Majority; these two indict even the most apolitical brand of fundamentalism for every crime from imperialism to threatening national security—Conway and Siegelman contend that American soldiers are neglecting their duties in order to hold Bible study and type Scripture into their radar consoles.

There's some good description of fundamentalist political activities, but here, too, the authors ruin their credibility with their intolerance of born-again—the same closed-mindedness they decry—and frequent use of hysterical statements like "we may soon be living in an America reborn of total propaganda and surrender to the supernatural." Conway and Siegelman's rhetoric makes Jerry Falwell look reasonable.

—*T. R.*

How to Make the Economy Succeed. *J. Morton Davis. Gardner.* An investment banker urges a need-based Social Security system, a "workfare" program, a national service program, curbs on the power of the Fed, a leaner defense budget, and a tax system that encourages productive investment. A trenchant and timely manifesto.

—*Phil Keisling*

The Hidden-Handed Presidency. *Fred I. Greenstein. Basic, $16.95.* The writer, a professor of politics at Princeton and one of the more thoughtful of the current crop of political scientists, has produced a valuable addition to the revisionist

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view of Dwight Eisenhower as a clever and more effective president than conventional historians have acknowledged.

Keeping Faith. *Jimmy Carter. Bantam, $24.95.* What this book makes clear is that Carter was wrong, not in being suspicious of Washington (it often does place its own interests above the public's) but in not understanding it well enough to guard against its worst and bring out its best.

The Rise and Decline of Nations. *Mancur Olson. Yale, $14.95.* The thesis of this brilliant book is that the longer a society enjoys political stability, the more likely it is to develop powerful special-interest lobbies that in turn make it less efficient economically. But the author seems unaware of the decline of the countervailing power of the political parties as an important factor in the increasing dominance of the lobbies in America.

—C.P.

Roots of Radicalism: Jews, Christians, and the New Left. *Stanley Rothman, S. Robert Lichter. Oxford, $27.95.* The authors conducted extensive psychological studies of student radicals of the late 1960s and early 1970s and found them driven more by a Machiavellian lust for power than utopian ideals. The book also examines why Jews, especially Jewish students, are so disproportionately at the forefront of radical movements. Some of the findings are interesting, but you have to travel down a Ho Chi Minh trail of academic jargon and dead prose to get to them. It's enough to make you glad they abolished graduate school deferments.

—Teresa Riordan

Strike for Freedom! The Story of Lech Walesa and Polish Solidarity. *Robert Eringer. Dodd, Mead, $11.95.* This very readable account of the charismatic electrician and the movement he inspired offers a dramatic overview of Solidarity's 16-month struggle but very little critical analysis. Eringer's thesis that, contrary to Western opinion, there was never a threat of Soviet or East German invasion is interesting but poorly documented.

—Jori Raymond

(continued from "Tilting at Windmills," page 10)

oblivion it so richly deserves. . . .

I am indebted to Colman McCarthy for calling my attention to the case of Lt. Joann Newak, who the air force has sentenced to six years of hard labor at Ft. Leavenworth, Kansas. Lt. Newak had an impeccable on-the-job record and was scheduled for promotion at the time of her court-martial. Her sins were confined to her off-base apartment, where she occasionally smoked marijuana, had an affair with another woman, and possessed pills that were alleged to be amphetamines but by the air force's own tests turned out to be simple diet pills.

Six years' hard labor? Losing a capable officer when the armed forces say they're short of capable people? Can you believe it? The armed forces are so concerned about the retention of capable people that they are offering reenlistment bonuses to 59 percent of their personnel. They don't have to give Lt. Newak a bonus—just let her out of Leavenworth. . . .

In general, by the way, I think the military's bonus policy is as stupid as the persecution of Lt. Newak. Instead of offering bonuses to 59 percent of all personnel—which is bound to include not only people you aren't that anxious to hold onto but also people in cushy jobs they would fight to keep—the bonuses should be concentrated on the skilled who are truly hard to retain. . . .

The same principle should be applied to other areas of public employment. With teachers we should concentrate on raises for good teachers only—let the marginal ones quit if they want to—particularly the good math and science teachers whose salaries may have to be increased as much as 50 to 100 percent to keep them from seeking private employment. In the state and federal civil service, the need for raises is even less—confined to the small minority, certainly not more than five percent, who could really make a lot more money elsewhere.

What has to stop is the mindless pattern of raises that are causing decreases in public services. The number of county government workers decreased last year by 45,000, while county payrolls increased by 7.6 percent. In New York, Ed Koch has instituted a hiring freeze on city employees while agreeing to a 15-percent increase in salaries over the next two years. Los Angeles has eliminated 1,995 jobs, reduced street repaving from once every 40 years to once every 120 years, cut down library hours to five a day, while increasing to 75 percent the proportion of its budget devoted to salaries and fringe benefits, including $98,908 to its police chief and $93,688 to its fire chief. During this recession year, state and local wage increases nationwide are actually higher than they were last year.

In the private sector, this same pattern of rising compensation without regard to the employer's ability to pay has been a central factor in our national economic decline. That decline, along with some of its causes and some possible cures, is the subject of this issue. . . .

It may be that the Reagan administration has succeeded in throwing away the one useful legacy of the Nixon-Ford years—the exploitation of the Sino-Soviet split that diverted our enemies' hostility from us to one another. Did you notice that China's representative at Brezhnev's funeral, Foreign Minister Huang Hua, was the highest-ranking Chinese to visit Moscow in over a decade, and that Andropov singled him out for special attention?

—Charles Peters

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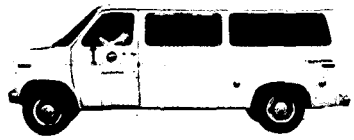

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